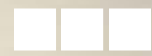
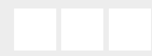


Putting our members first
Annual Report & Accounts

for the year ended 31 December 2015

the COVENTRY

TLC not PLC



Putting our members first

Coventry Building Society has a simple purpose. It exists to meet the needs of its current and future members for savings and residential mortgages.

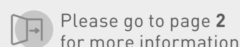
The Society has a long and consistent record of excellent performance, which was maintained in 2015. Further growth and strong profitability have added substantially to members' reserves. The Society continues to protect the interests of members. At the same time the Society continues to provide long-term value and excellent service.

Offering a genuinely member-focused approach, Coventry Building Society shows that an independent mutual organisation can succeed and prosper in an environment that continues to be challenging.

What makes us different?

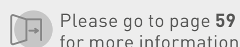
Committed to members

The Society's performance is underpinned by a commitment to fairness, marked by being independently ranked first for savings and mortgages in 2015 by Fairer Finance.


Please go to page **2** for more information

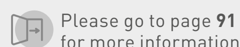
Listening to members

Being owned by members, the Society is committed to acting in their best interests at all times. The Members' Council is an example of how the Society gains the insight of members and uses these views across all areas of the business.


Please go to page **59** for more information

Spending money wisely

The Society's consistently strong financial performance is marked by robust control over costs and risks. This supports the Society in being able to deliver greater value to its saving and borrowing members.


Please go to page **91** for more information

The term 'Society' is used in this Annual Report & Accounts pages 1 to 90 to refer to the activities of the Society and its subsidiaries, except where the context indicates otherwise.

Coventry Building Society is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority (firm reference number 150892 www.fca.org.uk).

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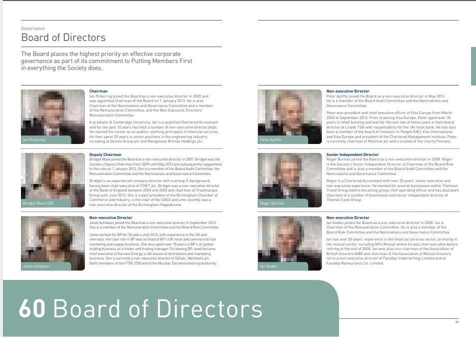

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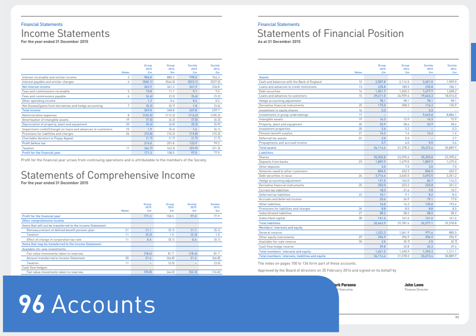

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Total value of charitable and community investment.

£2.5m

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Welcome to the

Strategic Report

This section provides commentary on the Society's 2015 performance, our overall business strategy and approach to risk management and corporate responsibility.

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For our full glossary please go to page **139**

What makes us different?
Case study

Committed to members
In 2015, independent consumer organisation Fairer Finance ranked the Society as No.1 for mortgages and savings.

The ratings, based on a mixture of statistical research and conversations with thousands of UK customers, were centred on four factors: customer happiness, trust, complaints and transparency. This shows the Society's ongoing commitment to Putting Members First.

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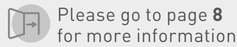
Performance Highlights 2015

Consistent and well-managed growth in mortgages and savings continues to deliver a stronger Society, for the benefit of all members.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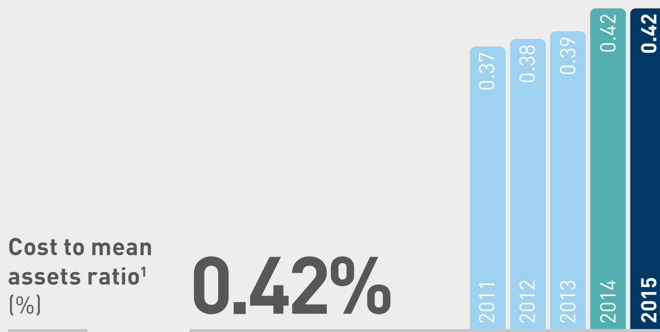
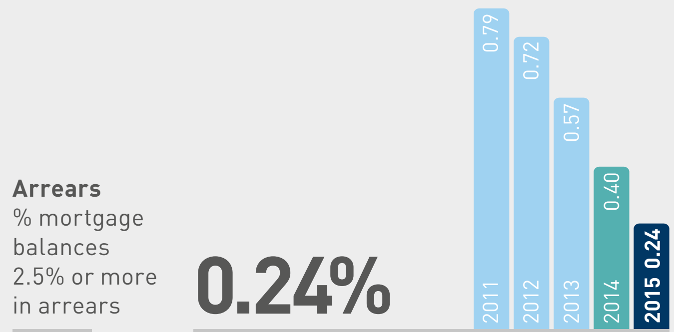
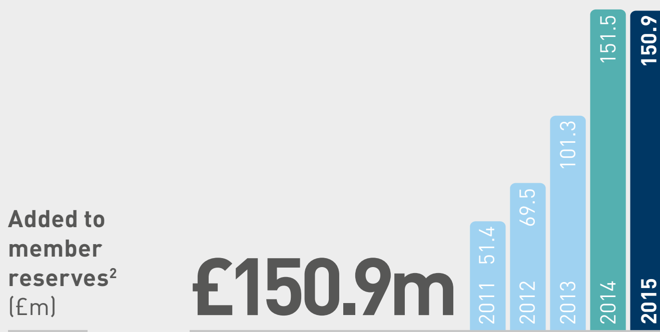
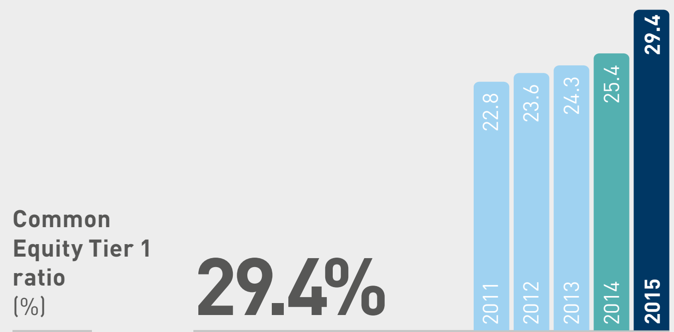








1. Administrative expenses, depreciation and amortisation/Average total assets.
2. Profit after tax including Additional Tier 1 capital distribution (net of tax). 2011 restated for comparative purposes to reflect accounting policy change in 2013 relating to timing of the Financial Services Compensation Scheme Levy – see 2013 Annual Report & Accounts note 1 for further details.

Strategic Report

Chairman's Statement

In 2015 we maintained our track record of profitable growth whilst delivering excellent service and value to our members.

Ian Pickering

Coventry Building Society delivered another strong performance in 2015, with a statutory profit before tax of £216.0 million, an increase of 7% over the prior year. The Society has maintained its consistent record of growth in a competitive environment, attracting more saving and borrowing members through a combination of excellent service and attractive products. As importantly, we continued to protect the interests of all members through our focus on managing risks and costs whilst investing appropriately to meet their future expectations.

In addition to a robust financial performance, the Society continues to deliver our mission of 'Putting Members First'.

The external environment remains challenging and uncertain. Commodity price falls, especially the price of oil, combined with slowing growth prospects in China have led to volatility in financial markets, particularly at the start of 2016. Although the UK economy saw growth in 2015, the Bank of England has downgraded expectations for growth for 2016, with inconsistent levels of activity across regions and business sectors. Reduced expectations for inflation have pushed forecasts for a rise in the Bank of England Base Rate further into the future. Whilst low rates have supported activity in the housing market, they continue to present real challenges for savers. The return of a majority Government in the May General Election reduced political uncertainty, but the referendum on the UK's membership of the European Union, due to be held on 23 June, is a further source of uncertainty.

One of the Society's strengths, however, is the consistency of its performance, whether in benign times or during the uncertainties of the financial crisis, and 2015 has proved to be another successful year. I am particularly pleased that, in addition to a robust financial performance, the Society continues to deliver our mission of 'Putting Members First'.

As a member-owned business I believe this is an entirely appropriate description of our purpose. It is one that the founders of the Coventry Economic Permanent Building Society would have recognised in establishing the Society in 1884 to provide local people with a safe home for their savings, using these funds to provide residential mortgages.

This remains our purpose in the 21st century and our ability to take the long view, rather than seeking to make short-term gains for external shareholders, underpins the decisions that we make on behalf of the Society's current and future members.

The ability of the Society to anticipate and adapt to changing circumstances, whilst meeting the needs of its members, is central to its long-term success.

This is why the Board remains convinced that it is in the best interests of members that Coventry Building Society should remain an independent mutual building society with a simple business model that offers long-term value to saving and borrowing members.

I believe that the building society model has an important part to play in today's financial services market, providing diversity and choice to customers as well as delivering greater value through effective competition. It also supports greater resilience in the financial services industry as a whole. Diversity in the financial services sector therefore provides both strength for the industry and benefits to individual customers.

The role of regulation in promoting diversity is increasingly being recognised and we welcome steps that enable different business models to flourish.

Regulation is also important in creating an environment in which customers' interests are appropriately protected. As a responsible organisation, we support all new regulations that will protect consumers and help instil public confidence in the market as a whole and in firms in particular.

The new Senior Managers Regime, which will come into effect in March 2016, places additional responsibilities on directors and senior managers of financial firms, including building societies. It is, of course, wholly appropriate that building society directors should be fully accountable to their members.

In December 2015 the Bank of England published a consultation on firms' minimum requirement for own funds and eligible liabilities (MREL). This requirement arises from the European Union Bank Recovery and Resolution Directive and is designed to minimise the risk of failing organisations requiring the use of taxpayers' funds. The implications of MREL are likely to require organisations such as the Society to issue additional amounts of capital prior to the implementation date in 2020.

> The ability of the Society to anticipate and adapt to changing circumstances, whilst meeting the needs of its members, is central to its long-term success.

The Bank Corporation Tax surcharge, which came into force in January 2016, will also have an impact on the Society's financial position. However, the Society is a strong and secure organisation, and I am confident that we can meet these additional demands whilst continuing to grow and meet the expectations of our members.

One of the Society's directors who has worked tirelessly in supporting members' interests since joining the Board in 2007, is stepping down in 2016.

Bridget Blow will be retiring from the Board at the conclusion of the Annual General Meeting on 28 April 2016. Bridget has served the Society and its members in a number of roles, including Deputy Chairman, Senior Independent Director and Chairman of the Remuneration Committee. I would like to take this opportunity to thank Bridget for her highly valued contribution to the Society's success and development over these years. A replacement for Bridget will be announced in due course.

In closing, I would like to extend my thanks to all employees for their commitment and contribution to what has been another successful year, and also to our members for continuing to support the Society, trusting us with their saving and mortgage needs.

Ian Pickering
Chairman
25 February 2016

Strategic Report

Chief Executive's Review

A successful year of savings and mortgage growth, with strong financial control and high levels of member satisfaction.

Mark Parsons

Coventry Building Society is a mutual organisation with a long and proud heritage. It is also a competitive and professional financial services provider that must meet the expectations of its modern membership. These expectations reflect the speed and choice which advances in technology have made possible. But they also reflect the need for security and trust that have been the basis of our relationship with members since the Society's formation in 1884.

The 2015 Annual Report & Accounts describes another performance that is financially strong and which maintains a successful record of growth based on low risk and low cost operations.

The financial performance is important and we are pleased to report strong results. However, it is more important that these results are achieved by doing the right things for our members, whether new to the Society or those who have been with us for many years. We describe this as 'Putting Members First'.

Underpinning this is a set of values that drives the way everyone at the Society acts and makes decisions. These values are to be Caring; Attentive; Reliable; Ethical; and Straightforward. Together they spell CARES, and Coventry CARES sums up the experience we are aiming to deliver for our members.

Central to this is providing long-term value to members. It continues to be a tough time for savers and in a low interest rate environment it is important that we provide competitive savings products not just today, but reliably and sustainably into the future.

We are achieving this. At the end of 2015 our average savings rate was 1.97% compared to a market average of 1.11%[1]. Furthermore, at the end of 2015 our average variable rate on cash ISAs was nearly two and a half times the market average[2].

Our ability to do this, whilst maintaining a very competitive mortgage portfolio, is underpinned by the high quality of our mortgage lending, which results in extremely low impairment charges, and our low cost operations. We continue to lead the sector in cost-efficiency, with our management expense ratio of 0.42%[3] remaining significantly lower than that of our peers[4].

We also strive to keep things simple, transparent and easy to use. To help achieve this we have commenced a four year technology programme that will deliver improved processes and systems, and provide our members with enhanced service options.

The evidence of our progress is shown by the views of members themselves. Whether calling about a savings account or visiting our branches, over 95% of members are satisfied with the service they receive with 9 out of 10 saying they would recommend us to friends or family[5].

However, Putting Members First also recognises that we can get it wrong sometimes, and when this happens our aim is to put things right as simply and quickly as possible.

Our commitment to this is shown by our record with the Financial Ombudsman Service, which overturned just 7% of Coventry cases it saw in 2015, compared with over 50% for the industry as a whole[6].

In 2015 the consumer organisation Fairer Finance independently assessed the performance of the largest financial service brands in terms of customer happiness, trust, complaint handling and transparency. It rated us No.1 for both savings and mortgages.

Trust is not only built on value and service, it also requires confidence in our financial strength and stability. Coventry Building Society remains a low risk financial services organisation. To illustrate this, since 2010, we have provided nearly 250,000 new mortgages, making losses on just 22 of them.

1. Weighted calculation comparing the Society balance mix of accounts to market mix as quoted by Bank of England (December 2015 data) for interest bearing sight deposits, interest bearing time deposits and Cash ISAs (excludes non-interest bearing current accounts, notes and coins and corporate/PNFC deposits).
2. Source: Bank of England. Average quoted interest rate on all variable rate cash ISAs including bonus accounts as at 31 December 2015.
3. Administrative expenses, depreciation and amortisation/Average total assets.
4. Top 10 building societies, latest published data, as at 25 February 2016.
5. Source: 14,716 branch customers and 18,313 savings contact centre customers in 2015.
6. Source: Financial Ombudsman Service – latest published data, as at 25 February 2016.

We continue to make an appropriate level of profit in order to maintain our capital strength whilst returning value to members in the form of competitive savings and mortgage rates.

In 2015, we increased profit before tax to £216.0 million, adding £150.9 million[7] to reserves. This increased our Common Equity Tier 1 ratio to 29.4% and our leverage ratio to 4.0%.

Our commitment to Putting Members First is based on, and delivered by our people. In our 2015 employee opinion survey, 98% of respondents agreed that the Society is 'committed to member satisfaction'– with 0% disagreeing. Overall employee engagement rose from 84% to 88% – the highest score recorded by the Society. Our engaged and motivated employees are what make the difference.

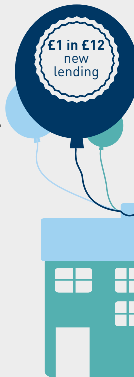
I believe the high level of engagement is not only based on doing the right things for our members but on the support we are able to give local and national causes. In 2015 we once again saw increasing employee involvement in fundraising and volunteering with nearly 200 community organisations benefiting from the skills and consideration of our people.

The outcome of all these drivers is a successful, member focused Society that is growing in a sustainable manner. Our mortgage balances have grown by 9% in 2015, five times the rate of market growth[8] and our savings balances by 8%.

The story of Coventry Building Society is the consistency of our performance, achieved in 2015's competitive market but also throughout the recent years of financial crisis and economic downturn. However, the real achievement has been to deliver this performance in the right way, by Putting Members First.

Mark Parsons
Chief Executive
25 February 2016

New lending
Our share of the net UK mortgage market lending was equivalent to £1 in every £12 of new lending growth[8].

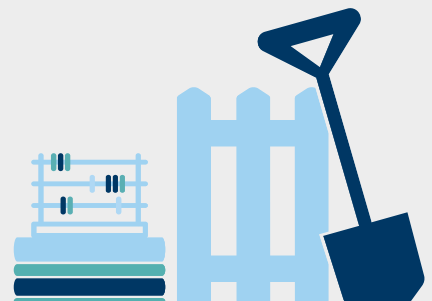


Complaints
The Financial Ombudsman Service changed just 7% of our cases compared with over 50% for the industry as a whole[6].

Savings
Our increase in ISA balances in 2015 was equivalent to £1 in £5 of the market growth in ISA balances[8].

Employee engagement
In the 2015 employee opinion survey, 91% of staff at the Coventry said that they were proud to work for the Society.

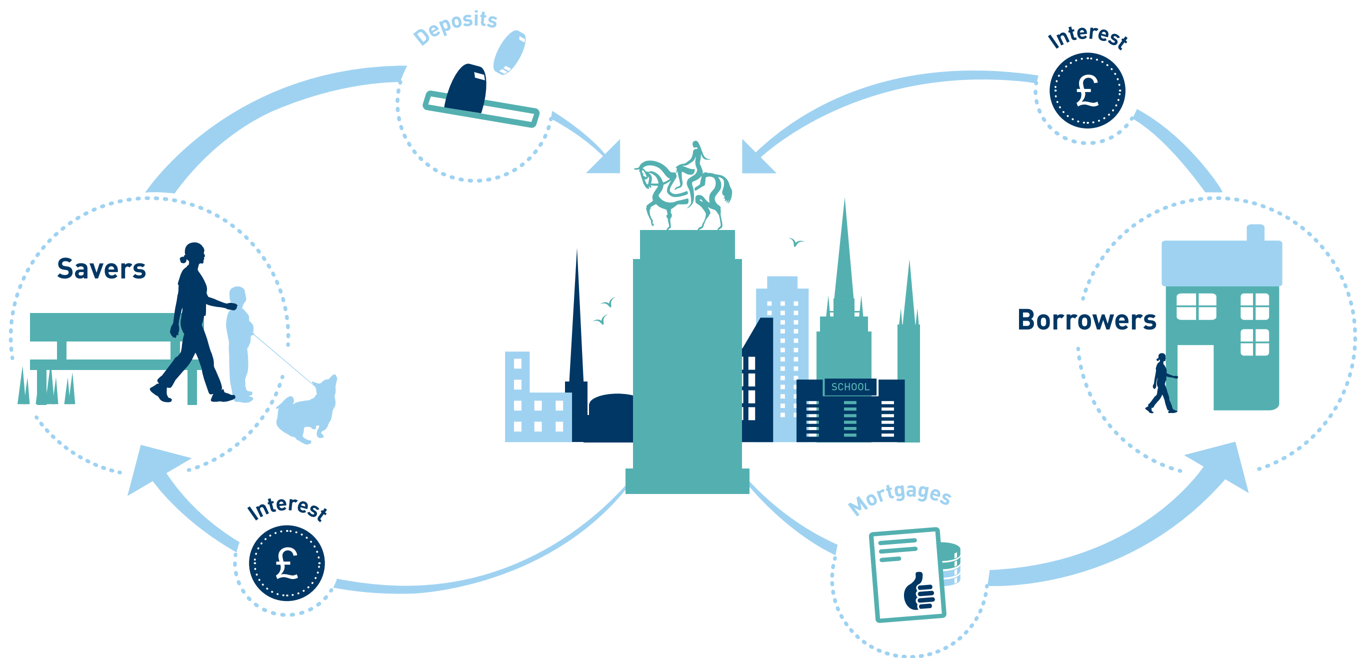
Community
Nearly two-thirds of our employees took part in our community programme through volunteering or fundraising.



7. Profit after tax including Additional Tier 1 capital distribution (net of tax).
8. Source: Bank of England.

Business Review

The Society's strategy is unchanged – sustainable growth, efficient operations and the provision of simple savings products and low-risk residential property mortgages.



Strategic Review

Objectives

The Society exists solely for the benefit of its current and future members, meeting their needs for savings and residential property mortgages. In delivering its strategic objectives, the Society is committed to Putting Members First in everything it does and fully embraces the mutual ethos on which it was founded. The Board continues to believe that members' interests are best served by remaining an independent mutual building society, with a clear purpose and a simple business model.

Business model

As a mutual building society, the Society is owned by its members and not shareholders. It operates within a legal framework with statutory limits set by the Building Societies Act 1986 to ensure a focus on its prime objectives of deposit taking and mortgage lending.

Even within this legal framework, the Board chooses to operate a very simple business model – simple products, simple ways of operating, and simple and transparent communications. It operates solely within the UK retail financial services market and only takes on risks that it understands and can manage. In order to ensure the business model is sustainable, capital generation is required to support future growth.

The Society accepts deposits from savings members and provides secured mortgage lending on residential properties. It also raises funds from the wholesale markets to provide diversity of source and term. The difference between the rates on mortgages and liquid assets and funding (retail and wholesale) provides the Society with net interest margin to cover operating expenses, impairment losses, provisions and taxation. The remaining profits provide the Society with the capital to support future growth and also protect members during periods of economic downturn.

As a mutual organisation, the Society does not have external shareholders or pay dividends; its customers have membership rights and are the 'owners' of the organisation. This creates clarity of purpose. The Society exists to serve its members and protect their interests, and strategic and operational decisions are taken with these responsibilities in mind.

Central to this is the provision of long-term sustainable value to members through competitively priced savings and mortgage products. The Society balances this with the requirement to protect members' interests by remaining financially strong and secure. As a result the Society aims to achieve sustainable levels of profitability rather than maximising profit, enabling it to provide improved pricing for its members. This longer-term strategic focus also enables the Society to maintain a longstanding and consistent presence in the savings and mortgage markets.

Strategic focus

The Society's strategy is unchanged from previous years and continues to be focused on:

- The provision of simple transparent retail savings products offering long-term value.
- Helping customers buy residential properties through low risk mortgage lending primarily via mortgage intermediaries but also through our branches and other direct channels.
- Sustainable growth realised without taking on excessive levels of risk in order to protect existing members during periods of economic stress, and to safeguard the Society's future.
- Efficient operations with effective use of technology to allow members to self-serve where they choose to do so and to maintain a cost advantage over competitors.
- Strong ethical standards and conduct principles supporting 'Putting Members First'. This extends to the recruitment, training and reward of employees, the design of products and services, and consultation with members about how the Society can better meet their financial needs for savings and mortgages.

> The Board chooses to operate a very simple business model – simple products, simple ways of operating and simple and transparent communications.

Future outlook

The pace and extent of regulatory change remains challenging. Of particular significance are the potential changes to capital requirements for the risk weightings of mortgage assets and the minimum requirement for total loss absorbing liabilities. These are considered in more detail in the Risk Management Report on page 58.

Since the publication of the 2014 Annual Report & Accounts, a Government with a small majority has been elected, easing fears of the destabilising effect that could have resulted from a hung Parliament. However, geopolitical uncertainty remains and there are continuing concerns over the financial situation in the Eurozone and slow growth in China and other emerging markets. This may adversely impact the UK recovery and the prospect of a potential UK withdrawal from the European Union creates further uncertainty.

The improvement seen in the UK economy through 2014 continued into 2015 with increased growth in savings and mortgage markets. However, slowing growth in the manufacturing sector and continued low productivity all point to an economy that, while improving, remains fragile. A first interest rate increase since 2007 could come in 2016 but is looking unlikely.

Business Review cont.

In the UK financial services sector, competition is continuing to increase with the prospect that established banking groups or new challenger organisations may be able to gain market share. This could impact the Society's growth plans, for example if competitors successfully compete in the mortgage intermediary distribution channel which is an area of strength for the Society, or if competition for retail funding intensifies. However, the Society's focused business model, established distribution relationships and low cost base, position it well to deal with these potential threats and to continue to grow and maintain its strong financial position.

> The Society will respond effectively to changes in the economic, regulatory and competitive environment to ensure performance is sustainable.

Both the Financial Policy Committee (FPC) and the Bank of England have expressed concerns with regard to the growth in the buy to let market over recent years. As a consequence, HM Treasury issued a paper in December 2015 consulting on additional powers to limit buy to let mortgage lending by reference to loan to value and interest coverage ratios. Changes to stamp duty on properties other than main residences are to be introduced from April 2016 and tax changes for buy to let owners to be introduced from April 2017 may also slow growth in this market. The Society will continue to carefully monitor the impact of these changes, and in the meantime will continue to maintain the high quality of its buy to let lending.

The new 8% tax surcharge on large financial institutions took effect from 1 January 2016 and will have an impact on the Society. The Society's Corporation Tax rate will therefore significantly increase from 2016.

Conduct redress arising from the inappropriate distribution of financial products is expected to continue for several years. The Society's consistent focus on Putting Members First has resulted in significantly lower provisions compared to many other organisations.

The Society has commenced a four year technology programme that will enable it to offer customers improved processes and systems and enhanced service options. The programme will enable the Society to remain competitive, help to contain operating costs and respond efficiently to future regulatory change and the changing needs of members.

The Society will remain flexible and respond to changes in the economic, regulatory and competitive environment to ensure that performance is sustainable and balances the needs of current and future members.

Principal risks and uncertainties

Further information on the Society's principal risks and uncertainties can be found in the Risk Management Report on pages 22 to 58.

Performance against the 2015 strategic goals

Performance against the 2015 strategic goals and key performance indicators, which are unchanged from 2014, is set out in tabular form below.

	Strategic goal	Key performance indicator	Performance in 2015
Financial measures	Financially strong and secure	Have a top quartile[1] Common Equity Tier 1 (CET 1) ratio. Meet non-risk based capital measures with an appropriate buffer.	Highest reported CET 1 capital ratio of our peer group[1] at 29.4%. Leverage ratio of 4.0%, on an end-point basis, exceeds regulatory minimum of 3.0% (currently only applicable to organisations with retail deposits in excess of £50 billion).
	Low risk lending	Impairment charges in the lowest quartile of peer group average[1].	Arrears continue to be lower than the industry average[2]. No impairment charge during 2015, due to a significant reduction in arrears and an improvement in house prices.
	Highly cost-efficient	Lowest reported cost to mean assets ratio[3] of our peer group[1].	At 0.42%[3], this measure is expected to remain comfortably the lowest of the peer group[1] and less than half the total building society average[4].
Non-financial measures	Grow our membership	Demonstrate an increased share of the UK savings and mortgage markets.	The Society's share of savings and mortgage stock increased in 2015, reflecting a trend that has seen it grow its share of both every year over the last nine years[5]. The number of customers increased by over 56,000 during 2015, and the number with either a savings or mortgage account totals nearly 1.8 million.
	Competitively priced products offering long-term value	Offer savings and mortgage rates that are attractive versus market rates.	At the end of 2015 our average savings rate was 1.97% compared to a market average of 1.11%[6]. In addition, our mortgages have also been in the national press best buy tables every week for over two years.
	High levels of customer satisfaction	High levels of customer satisfaction and customer advocacy, and low levels of complaints referred to the Financial Ombudsman.	9 out of 10 members who visit our branches or call our savings contact centre say they would recommend us to friends and family[7]. In the latest figures, the Society recorded 1.3 complaints per 1,000 members, one of the lowest rates of any top 10 building society[8].
	Strong employee engagement	Employee engagement scores above external high performance benchmarks.	The employee engagement score in the Society's 2015 employee opinion survey was 88% – 15% above the financial services benchmark used by an independent third party. The Society also continues to hold a Gold Award from Investors in People.
	Support our communities and wider society	Continue to make a tangible difference to local communities and national charities via fundraising and volunteering activities.	In 2015, the total contributions as a result of the Society's charitable activities reached £2.5 million, including affinity savings accounts. Furthermore, nearly two-thirds of employees took part in our community programme through volunteering or fundraising.

1. Unless otherwise stated, performance is measured against a peer group of the 10 largest building societies, by total assets from latest published annual results.
2. Source: Prudential Regulation Authority - latest available information, as at 30 September 2015.
3. Administrative expenses, depreciation and amortisation/Average total assets.
4. Source: Building Societies Association: Annual Accounts Data 2014.
5. Source: Bank of England.
6. Weighted calculation comparing the Society balance mix of accounts to market mix as quoted by Bank of England (December 2015 data) for interest bearing sight deposits, interest bearing time deposits and Cash ISAs (excludes non-interest bearing current accounts, notes and coins and corporate/PNFC deposits).
7. Source: Surveys of 14,716 branch visitors scoring 9 or 10/10 and 18,313 savings contact centre callers scoring 4 or 5/5 during 2015.
8. Source: FCA - latest published information: 1 January 2015 to 30 June 2015.

These goals remain the strategic priorities for 2016 to 2020.

For further information of the Society's financial performance, please read the Financial Review overleaf; for non-financial performance, please read the Corporate Responsibility Report on pages 18 to 21.

Strategic Report

Business Review cont.

Financial Review

Income Statement

Overview

Statutory profit before tax has increased by 7% to £216.0 million. Whilst the Society does not aim to maximise profit, it is the key source of capital to protect members' interests and to support growth. In this context, both underlying and statutory profit measures have increased in 2015. This continues a track record of sustainable profitability that has seen the Society achieve strong levels of profit throughout the financial crisis.

Statutory and underlying profit are set out in the summarised Income Statement below:

Year to 31 December 2015	Statutory profit £m	Financial Services Compensation Scheme levy £m	Movements on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	363.9	–	–	363.9
Other income	5.4	–	–	5.4
Losses on derivatives and hedge accounting	(0.3)	–	0.3	–
Total income	369.0	–	0.3	369.3
Management expenses	(137.4)	–	–	(137.4)
Impairment credit	1.9	–	–	1.9
Provisions	(15.8)	14.1	–	(1.7)
Charitable donation to Poppy Appeal	(1.7)	–	–	(1.7)
Profit before tax	216.0	14.1	0.3	230.4

Year to 31 December 2014	Statutory profit £m	Financial Services Compensation Scheme levy £m	Movements on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	341.3	–	–	341.3
Other income	8.2	–	–	8.2
Losses on derivatives and hedge accounting	(0.7)	–	0.7	–
Total income	348.8	–	0.7	349.5
Management expenses	(124.6)	–	–	(124.6)
Impairment charge	(5.4)	–	–	(5.4)
Provisions	(15.3)	15.3	–	–
Charitable donation to Poppy Appeal	(1.7)	–	–	(1.7)
Profit before tax	201.8	15.3	0.7	217.8

Net interest income

Net interest income at £363.9 million is £22.6 million higher than the previous year, primarily as a result of growth in mortgage assets offset by a slight decrease in the net interest margin. The increase in net interest income was a key driver in the increase in both underlying and statutory profit before tax. The Society's net interest margin has decreased marginally by 4 basis points to 1.11% in the year to 31 December 2015.

	Year to 2015 £m	Year to 2014 £m
Net interest income	363.9	341.3
Average total assets	32,696	29,766
	%	%
Net interest margin	1.11	1.15

This is as a result of increased competition for mortgage customers and the impact that this has had on new business margins and redemption levels. The Board has taken the decision not to seek to recover all of this reduction from reducing the interest paid on savings accounts. The Board believes that there will be a further decrease in the net interest margin in future years as a consequence of continuing competition in the mortgage market and the need to refinance borrowings from the Bank of England's Funding for Lending Scheme (FLS).

Savings rates paid to existing account holders have continued to fall across the industry during the year and, although the Society has taken selective action to reduce rates on some of its accounts, it has not done so to the same extent as many of its competitors. The Board therefore continues to manage the net interest margin to deliver value to members through both attractive savings rates and competitive mortgage products.

For example, at the end of the year, over 95% of variable rate cash ISA balances paid at least 1.7% which is double the average market rate of 0.85%[1]. Furthermore, a Coventry ISA product has been in the national press best buy tables every week for over three years.

In addition, as at the end of 2015 over 80% of the Society's variable rate balances paid at least three times the Bank of England Base Rate.

This translates to an additional £66.0 million[2] of interest received by members compared with average market rates of interest. This demonstrates the delivery of a key strategic goal.

1. Source: Bank of England. Average quoted interest rate on all variable rate cash ISAs including bonus as at 31 December 2015.
2. Based on monthly weighted average savings rates and balances versus Bank of England average quoted interest rates for instant access variable non ISA and variable rate cash ISA balances.

The Board continues to balance achieving this goal with the need to protect the overall financial strength of the Society and meet increasing capital requirements by bolstering reserves through retained profits, providing assurance and security to all members (see page 17).

Other income

Other income is not a strategic priority for the Society, which remains focused on the provision of savings and mortgage products.

Other income has reduced to £5.4 million (2014: £8.2 million). The primary driver for this decrease was the decision to remove booking fees on mortgage applications in the year. This was partially offset by a £0.8 million profit on the sale of investment properties.

Derivatives and hedge accounting

The Society uses derivative financial instruments to manage various aspects of risk and in doing so complies with the Building Societies Act 1986, which limits the use of derivatives to the reduction of risk (hedging) arising from changes in interest rates, exchange rates or other market indices.

Even though the Society uses derivatives exclusively for risk management purposes, Income Statement volatility arises due to the accounting ineffectiveness of designated hedges. The Board believes that this volatility arises from application of the accounting rules rather than because of economic reality and consequently it is excluded from underlying profit. An analysis of the net loss from derivatives and hedge accounting is set out in note 7 to the accounts.

Management expenses

Management expenses for 2015 were £137.4 million (2014: £124.6 million). The increase is a reflection of the growth of the Society, the costs of servicing a larger membership, continuing investment in the Society's core IT infrastructure and the Society's response to ongoing regulatory requirements.

There has been significant growth in employee costs in 2015, in order to provide additional resource to comply with new regulations and also to improve the quality of service offered to members. The Society continues to invest in ensuring that its core IT infrastructure and systems are robust and secure, and are able to support increased functionality and methods of distribution, including developments in online services. This is an area where investment is likely to increase. Depreciation and amortisation of property, plant and equipment and intangibles have also increased to £12.9 million (2014: £12.3 million). During the year, the Society acquired additional premises in Coventry to support its continued growth.

Business Review cont.

Despite the absolute increase in management expenses, the Society's ratio of costs to mean total assets has remained unchanged at 0.42%. For over 10 years the Society has achieved the lowest reported cost to mean asset ratio of all UK building societies and expects to retain this position comfortably for 2015.

Continuing cost pressure is expected, arising from sustained levels of investment in technology, increased regulation and organic growth. The Society has also commenced a four year technology investment programme that will provide members with a broader choice of products and transform the way they interact with us, such as opening and servicing their accounts, as well as improving our internal processes and systems. The Society's ability to grow whilst retaining control of costs continues to represent a significant competitive advantage.

Impairment credit

There was a net release of incurred loss provision of £1.9 million in 2015 (2014: £5.4 million charge). This release is a reflection of improving economic conditions, including moderate house price growth, prolonged low interest rates, falling unemployment, and wage increases outstripping increases in the cost of living.

The Society has a strong record of low impairments, reflecting the success of its low risk lending strategy which has always been a key element of its business model. Other than as a result of small books acquired as part of the merger with Stroud & Swindon in 2010, the Society has never undertaken commercial lending or second charge lending and its exposure to unsecured lending is negligible with no new lending of this type since 2009.

Provisions

The £15.8 million provision for liabilities and charges comprises £14.1 million for the Financial Services Compensation Scheme (FSCS) levy and £1.7 million for Payment Protection Insurance (PPI). The £15.3 million charge in the prior year is in respect of the FSCS levy only. The Society pays levies to the FSCS based on its share of protected deposits and such levies are excluded from underlying profit.

The PPI charge in the year reflects a small increase in the amount settled per case, and the impact of the proposed introduction of a deadline for PPI claims. Provisions for PPI claims continue to be materially lower for the Society than for many other organisations. This is a consequence of the design of the PPI product previously offered by the Society. Further information on the provisions for liabilities and charges is included in note 26 to the accounts.

Charitable donation to the Poppy Appeal

The Society donated £1.7 million to The Royal British Legion's Poppy Appeal during the year (2014: £1.7 million). The contribution to this appeal since 2008 now totals £12.6 million.

Taxation

The Board strongly believes the Society should contribute its fair share of tax and in 2015 the Corporation Tax charge arising on profits earned was £44.7 million (2014: £43.3 million). This represents an effective rate of tax of 20.7% (2014: 21.5%) which is marginally more than the statutory corporate tax rate of 20.25% (2014: 21.5%). This is due to expenses not deductible for taxation purposes and the impact of the Bank Corporation Tax surcharge on deferred tax balances. The Society's Corporation Tax rate will increase significantly in 2016 as a result of the Bank Corporation Tax surcharge.

Balance sheet

Overview

Mortgage balances have grown by 9% from £27.0 billion to £29.4 billion in the year, primarily funded by an increase in retail funding of £2.0 billion and wholesale funding of £0.7 billion. Equity increased by £0.2 billion and on-balance sheet liquid assets by £0.4 billion.

	2015 £m	2014 £m
Assets		
Loans and advances to customers	29,411.0	26,959.6
Liquidity	4,375.3	3,950.2
Other	328.1	368.5
Total assets	34,114.4	31,278.3
Liabilities		
Retail funding	25,355.8	23,395.6
Wholesale funding	6,336.0	5,604.3
Subordinated liabilities and subscribed capital	219.8	219.8
Other	551.3	567.7
Total liabilities	32,462.9	29,787.4
Equity		
General reserve	1,222.3	1,061.9
Other equity instruments	396.9	396.9
Other	32.3	32.1
Total equity	1,651.5	1,490.9
Total liabilities and equity	34,114.4	31,278.3
Unencumbered FLS Treasury bills (off-balance sheet liquidity)[1]	1,142.2	616.3

1. Treasury bills (obtained under the FLS quoted at market value above) provide very high quality liquidity but, in accordance with accounting standards, whilst unencumbered, are not recognised on the balance sheet, as the Society does not retain the risk and rewards in relation to these assets.

Loans and advances to customers

The Society's lending strategy for owner-occupier and buy to let mortgages is focused on high quality low loan to value loans within the prime residential market, through competitively priced mortgages. These loans are primarily distributed through UK-wide third party intermediaries, and to a lesser extent through a number of advisors within the Society's network of branches and the Coventry-based contact centre.

In 2015, the Society advanced £8.0 billion of mortgages, an 8% increase over 2014 (2014: £7.4 billion), in line with the market growth in gross mortgage lending[3].

The Society's mortgage balances increased as a result of organic growth by £2.5 billion (2014: £2.8 billion). This resulted in our market share of UK mortgage balances growing to 2.3%[3] (2014: 2.1%) in what has been an increasingly competitive mortgage market.

The increase in the Society's mortgage balances is after the sale of £0.3 billion non-member buy to let mortgages in the final quarter of the year (for more information, see the Regulatory capital section on page 17).

The growth in the mortgage book has been achieved whilst retaining the Society's focus on low risk lending. The result is an overall indexed loan to value of the mortgage book at 31 December 2015 of 48% (simple average), a position that is largely consistent with previous years (2014: 49%).

The result of this responsible lending approach is highlighted by an arrears performance which is significantly better than that of the industry as a whole and impairment charges which are consistently amongst the lowest reported by any top 10 mortgage lender.

As at 31 December 2015, 0.24% of mortgage balances were 2.5% or more in arrears (2014: 0.40%). At the time of the latest published data[4], arrears were 27% of the industry average. At the end of 2015, just 32 properties were in possession (2014: 52) from a total population of nearly 240,000 accounts.

This performance underlines the Society's sustainable commitment to the UK housing market during a period in which new mortgage lending as a whole still remains lower than pre-2008 levels[3].

3. Source: Bank of England.
4. Source: Prudential Regulation Authority - latest available information, as at 30 September 2015.

Business Review **cont.**

Liquidity

On-balance sheet liquid assets have increased to £4.4 billion (2014: £4.0 billion). Including unencumbered Treasury bills drawn under the FLS, total liquid assets held have increased by £1.0 billion. Liquid assets continue to be held primarily in deposits at the Bank of England and UK Government securities.

The credit quality of liquid assets remains high with 95% of the portfolio rated Aaa–Aa3 (2014: 94%) and 5% rated A1–A3 (2014: 4%). The Society has no direct exposure to the peripheral Eurozone countries.

As at 31 December 2015, no amounts in the liquid asset portfolio were either past due or impaired and as such no impairment provision has been made.

Of the £4.4 billion liquid assets, £1.6 billion are held as Available-for-sale (AFS) and under IFRS are marked-to-market with any changes in value recorded through other comprehensive income. The non-AFS assets are loans and advances to credit institutions or deposits with the Bank of England. As at 31 December 2015, the balance on the AFS reserve was £2.5 million gain, net of tax (2014: £0.7 million loss, net of tax).

On-balance sheet liquid assets are supplemented by additional high quality off-balance sheet liquid assets which are readily available to meet cash flow requirements. The Liquidity Coverage Ratio at 31 December 2015 was 141%, comfortably above the minimum regulatory requirement.

Retail funding

The Society continues to be predominantly funded by retail savings, which have increased by £2.0 billion to £25.4 billion at 31 December 2015 (2014: £23.4 billion). Our share of the growth in the retail savings market for the year was 2.8%, over 50% higher than our natural share[5].

As has been the case throughout the financial crisis, the Society has maintained a competitive stance in the retail savings market and has chosen to increase retail funding despite the availability of cheaper wholesale funding. This is a reflection of one of the core objectives; to offer our members an attractive rate of interest and a safe home for their savings.

Despite increased competition in the UK savings market, the Society has maintained competitive savings rates for both new and existing members in both ISA and non-ISA markets. Our growth has been particularly noticeable in the cash ISA market with an account balance growth of 57%. Across all savings products 215,000 new accounts were opened in 2015.

Over 93% of mortgage balances are funded by retail savings or capital.

Wholesale funding

The Society uses wholesale funding to provide diversification by source and term and also to provide value to members through lowering the overall cost of funding.

In 2015, on-balance sheet wholesale funding increased by £0.7 billion with a year-end balance of £6.3 billion (2014: £5.6 billion). During the year, the Society issued a £500 million five year floating rate covered bond, which replaced a maturing bond and subsequently raised an additional £150 million from the same issuance.

Off-balance sheet wholesale funding drawn down through the FLS increased to £2.0 billion (2014: £1.3 billion).

Equity

The Society's equity is predominantly made up of its General reserve and Additional Tier 1 (AT 1) capital (other equity) but also includes the Available-for-sale reserve and cash flow hedge reserve. The Society's total equity increased by £0.2 billion over the year to £1.7 billion (2014: £1.5 billion), driven by profits generated during the period.

5. Source: Bank of England.

Regulatory capital

The Society's capital position on an end-point basis as at 31 December 2015 is summarised in the following table. The increase in CET 1 capital, total Tier 1 capital and total capital is primarily driven by profit after tax of £171.3 million.

Despite a 9% growth in the mortgage book, risk weighted assets have marginally decreased as a result of house price inflation reducing effective risk weights and the transfer of an existing portfolio from a Standardised basis to an Internal Ratings Based basis.

The Society completed a whole loan sale of its beneficial interests in £0.3 billion of non-member buy to let mortgages originated by its subsidiary Godiva Mortgages Limited (Godiva) to a third party in the final quarter of the year. These mortgages have been derecognised from the Group's balance sheet – see note 18 to the accounts. Similarly, as the Group does not retain any economic interest in the transferred mortgages and has not provided any financing to the third party entity. From a regulatory capital perspective the mortgages are not required to be risk weighted or included as an off-balance sheet exposure in the calculation of the leverage ratio.

The movements described above have resulted in an increase in the Society's CET 1 ratio from 25.4% to 29.4% and in its leverage ratio from 3.9% to 4.0%. At 31 December 2015, and throughout the year, the Society complied in full with all of the regulatory capital requirements that were in force.

	End-point 31 Dec 2015 £m	End-point 31 Dec 2014 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	1,167.2	1,011.2
Total Tier 1 capital	1,564.1	1,408.1
Total capital	1,568.4	1,414.2
Risk weighted assets	3,974.6	3,977.2
	%	%
Capital and leverage ratios:		
Common Equity Tier 1 (CET 1) ratio	29.4	25.4
Leverage ratio[1]	4.0	3.9

1. The leverage ratio is calculated in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation. The calculation reflects constraints in the inclusion of Additional Tier 1 capital in accordance with the FPC's leverage ratio regime regulations.

Additional information

Further analysis is set out in the Risk Management Report as follows:

- Loans and advances to customers on pages 30 to 36.
- Treasury credit risk on pages 36 to 39.
- Liquidity on pages 42 to 43.
- Wholesale funding on pages 43 to 46.
- Capital and its management on pages 52 to 58.

Strategic Report

Corporate Responsibility Report

Coventry CARES about its members, about employees, the environment and about the communities we serve.

WELLBEING PROGRAMME

FLEXIBLE WORKING

IIP GOLD

CARES about employees

CARES about members

CARES about communities

SCHOOL

CARES about the environment

Coventry CARES
The Coventry has been looking after our members' finances for over 130 years, and today we are proud of our record as one of the nation's strongest building societies. Our financial strength means that we can provide excellent value savings and mortgage products to our members, jobs and career development for our employees, and social and economic benefits to our local communities.

By putting members at the heart of what we do, our products, services and processes are developed in a responsible way. To articulate this approach, 2014 saw the launch of our new CARES framework – Caring, Attentive, Responsive, Ethical, Straightforward. Everything we do, whether developing a new savings product, identifying how we can protect member finances, or providing career opportunities is led by these values. Coventry CARES demonstrates the full scope of our corporate responsibility.

Most trusted savings account provider award – Moneywise Customer Service Awards 2015.

Coventry CARES about members
As a mutual organisation, we are clear that our first priority is to our members – ensuring that their money is safe, that our products are simple, fair, and fit for purpose, and our service is of an excellent standard. We also believe it is important to listen to our members to ensure that we are meeting their expectations.

The long established Members' Council, attended by non-executive and executive members of the Board, as well as senior managers of the Society, meets on a quarterly basis and provides insight and feedback on an agenda that is jointly determined by Council members and the Society.

We also listen directly to members, whichever way they do business with us, to understand how we can improve what we do, and in 2015 the views of over 60,000 helped us to deliver a service we could be proud of.

Our commitment to great service is also shown by the low level of complaints we receive and our sector-leading performance in resolving them.

At the heart of our responsible approach to doing business is providing simple, fair savings and mortgage products that offer security and long-term value.

Our products consistently appear in best buy tables for both savings and mortgages, and all our new business products are offered on the same terms to both new and existing customers.

Whilst our ability to offer competitive products is evidenced by our consistent growth, we are equally proud of our record in protecting borrowing members through responsible lending and all members against an ever changing backdrop of financial crime.

Consumer champion organisation, Fairer Finance, rated us first for savings and mortgages and awarded us their gold ribbons in 2015.

Corporate Responsibility Report **cont.**

Coventry CARES about employees
We deliver the products and services that our members deserve because we have a workforce that is talented, committed, and fully supported. We are proud of our track record as an employer of choice and continue to look for ways to ensure we have the very best people doing their very best work.

As a long standing participant in the Investors in People (IIP) scheme we were delighted to be re-awarded the IIP's Gold Standard in 2015. The report commended the Society for its "excellent, integrated strategies for managing and developing people based upon a shared set of values and a strategy that is understood by all."

Our aim is to identify, recruit and retain people who understand and share our values and aspirations. In return we offer opportunities for personal and career development and the security that comes from being part of a growing business.

We continue to work hard to give all employees the opportunity to succeed. A new Employee Value Proposition, which brings to life what we expect of our employees as well as what they can expect from the Society, was developed during the year. The Society also supplemented the extensive role based training which is firmly embedded, with an increased focus on leadership and management development.

Once again, we achieved Investors in People Gold standard.

A new flexible working policy together with regular internal careers fairs encourage employees to consider the different ways they can develop their careers at the Society.

92% of employees completed our annual employee opinion survey with the overall engagement score of 88% being 15% higher than the financial services benchmark used by an independent third party.

88%

Coventry CARES about the environment
As a large organisation, we inevitably have an impact on the environment. We have identified our principal impacts on the environment as being the carbon we use in heating and lighting our buildings, and to a lesser extent our use of transport, and the resources we use including paper, water and office consumables.

In 2015 we introduced a number of initiatives designed to reduce the amount of general waste we send to landfill, including a new waste disposal contract and a focus on recycling across head office sites, which enabled us to make good progress towards our target of 0% going to landfill by 2016.

We also commissioned a full review of our carbon footprint which will ensure that we comply with the 'Energy Savings Opportunity Scheme' (ESOS) administered by the Environment Agency and designed to improve the energy efficiency of the Society's buildings.

Our new waste contract means that we have reduced our general waste to landfill by 97% with a target of reaching 0% to landfill in 2016.

97%

Coventry CARES about our communities

In addition to the economic impact the Society has as a large local employer, we have a valuable contribution to make to the communities where we are based. Feedback from employees and members shows that our branches offer far more than financial services, but are an important presence in their communities, offering a range of support to members, as well as a friendly face.

Volunteering is an increasingly sought after way of supporting local communities and in 2015 our employees volunteered more than 3,625 hours. To support this we launched our new skills-based volunteering database which aims to match up the professional skills our employees have with local charities, community groups, and schools that do not have access to such skills.

We have also extended the support we offer to schools; from executives providing strategic advice as governors, to reading and number partners, from improving financial literacy to providing careers support. In each case, we ask for employee volunteers and encourage them to use the opportunity to develop their own skills.

The enthusiasm and commitment of our employees means we are supporting more organisations than ever before, from national events like Children in Need to a range of local charitable groups. We continue to encourage employee involvement because of the difference we are able to make, but also because of the positive impact on employee engagement and motivation. Our support extends to volunteering time away from work, community grants and matched funding, as well as the Society's Charitable Foundation which has donated over £1 million to locally-based charities since its launch in 1998.

Local support is also the key to our Community Partner programme. Branch and head office teams choose a local charity to work with and we now have 60 partnerships in place. As well as the support provided by our local teams we also help these community partners by raising money at a Society level and using this to provide small but very valuable grants.

We continue to have great support from members and employees alike for our partnership with The Royal British Legion which began in 2008. Since then, the success of our Poppy range of savings accounts has led to donations of £12.6 million, together with an increasingly active volunteering programme that has involved employees in commemorative events and fund raising.

In 2015, the Society's total community investment was £2.5 million.

£2.5m

Raising aspirations

Improving financial literacy

Making numbers exciting

FUNdraising hard

Risk Management Report

Introduction and principal risks

This Risk Management Report explains the Society's business, the principal risks it is exposed to and how it manages these risks. Given capital is the means by which the Society seeks to protect members from the impact of a risk event, this report also summarises the capital position and provides an assessment of its adequacy.

The risks to the organisation are managed on a Group basis to include the Society and its subsidiaries. The term 'Society' is therefore used in this report to include the activities of the Society and its subsidiaries.

The Society is a mutual organisation run for the long-term benefit of its members. The Board adopts a prudent approach to managing risk choosing to operate a very simple business model – simple products, simple ways of operating, and simple and transparent communications. The Society operates solely within the UK retail financial services market and only has appetite for risks that are understood, can be managed, and are necessary to achieve the Society's strategic objectives.

The risk classes inherent within the business are set out below and within each of these classes, the Society's principal risks are also set out. The Society defines a principal risk as 'an inherent risk exposure that could materially compromise the Society's ability to grow and provide attractive products to saving and borrowing members'.

Risk class	Brief definition
Credit risk	Credit risk is the risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Within this class, the Society considers risks arising from retail credit risk and treasury credit risk to be individual principal risk categories.
Market risk	Market risk is a collective principal risk category and is defined as the risk that the value of net income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign currencies.
Liquidity and Funding risk	Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk.
Conduct risk	Conduct risk is a principal risk category. Conduct risk is the risk that the Society's actions fail to deliver good customer outcomes.
Operational risk	Operational risk is the risk of loss arising from inadequate internal processes, systems or people, or from external events. The Society assesses the risks at a more granular level against which the following are considered to be the principal operational risk categories: legal and regulatory, IT systems, information security, financial crime and people.
Business risk	Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors. The Society considers strategic risk, the risk to delivering the Strategic Plan, to be the principal business risk.

In addition to these principal risks, the Society is also exposed to model risk. Models are used extensively within the Society to drive management decisions, informed by modelled projections of financial performance, and to assess the Society's resilience to a stress event. Failure in the design of a model or in the assumptions used may lead to an adverse outcome. Given that models are frequently used in the assessment and monitoring of principal risks, model risk is therefore a feature of each of the categories above. The Society uses a variety of techniques to mitigate model risk, including sensitivity analysis to key assumptions. A formal committee is dedicated to the oversight of the Internal Ratings Based (IRB) models and considers validation reports from independent third party experts.

Pension obligation risk exists by virtue of the Society having previously offered a defined benefit pension scheme. As at 31 December 2015 the scheme had a surplus of assets over liabilities of £14.2 million under IAS 19 *Employee Benefits (Revised)*. The scheme was closed to new entrants in 2001 and to future service accrual during 2013. These actions have served to reduce the potential volatility of the scheme's liabilities. Pension obligation risk is not considered to be a principal risk.

Controlling and managing risk

Overview

The Society's risk management approach has continued to evolve during 2015 following the developments introduced during 2014 where the Society improved the documentation and evidencing of its approach to risk management through the formalisation of an Enterprise Risk Management Framework (ERMF). The primary purpose of the ERMF is to set out the Board's approach to managing risk and the provision of oversight by defining and documenting the Society's purpose and objectives; risk strategy; risk appetite; governance and control; and risk management together with the principles upon which the framework is based. The ERMF was successfully implemented in 2015 which has resulted in a more consistent approach to risk management across all risk categories.

The focus in 2016 is on embedding further the ERMF through continued enhancement to ensure it evolves in accordance with future developments in best practice and regulatory requirements.

The Society's approach to how it controls and manages risks is set out in the sections that follow.

The Society's purpose and objectives

The Board determines and regularly revisits the Society's purpose and objectives through the annual strategic planning process. The risk management process complements and supports the Society's Strategic Plan.

The Society exists solely for the benefit of its current and future members, meeting their needs for savings and residential property mortgages. In delivering its strategic objectives the Society is committed to Putting Members First in everything it does and fully embraces the mutual ethos on which the Society was founded. These objectives therefore drive the risk appetite adopted by the Society to be a 'below median risk mutual' and set a strong risk culture in which it operates.

The Society operates a very simple business model – simple products, simple ways of operating and simple and transparent communications. It operates solely within the UK retail financial services market and only takes on risks that are understood and can be managed.

Risk Management Report **cont.**

Risk strategy

Set by the Board, the risk strategy translates the Society's purpose and objectives into an approach to risk management that incorporates risk culture, the Board risk appetite and the definition of the Society's risk governance principles including the adoption of the 'three lines of defence' model (see diagram on page 25).

Risk culture

Risk culture is derived from the Society's strategic principles and values, and supports the achievement of the Society's stated purpose and objectives. Risk culture is defined as the normal attitudes and behaviour exhibited by employees at all levels with regard to risk awareness, risk taking and risk management.

The Society's risk culture is built on the following three elements:

- Tone from the top – the Board and executive management encourage employees to act with integrity, especially in the fair treatment of customers, and to escalate observed non-compliance. Employees are encouraged to report risk incidents and 'near misses'.
- Accountability – employees understand the core values of the Society and therefore the approach to risk. Where individuals have specific responsibilities with regard to risk, these are included within role profiles and objectives and employees understand that they will be held accountable for their actions and risk taking behaviours. This is supported by the Society's performance management process. These accountabilities will be further formalised in 2016 under the Senior Managers Regime.
- Incentives – the Society's performance management arrangements promote the Society's desired risk management behaviours and attitudes. In particular, the Society does not operate any sales incentives for employees.

Board risk appetite

The Board sets high level risk appetite statements to provide a framework for business decision making and to identify and articulate the risks that the Board is willing to take in delivering the Strategic Plan.

The Board has a risk philosophy to be a 'below median risk mutual' which also provides a backstop against the underlying risk appetite statements and limits for each of the Society's risk categories. Additionally, the Board has set a requirement that the Society is able to withstand a severe but plausible stress and still report an accounting profit and meet minimum capital requirements. The Society operates with a lower level of risk than its stated appetite or boundary conditions, if it is possible to do so and still meet its Strategic Plan targets.

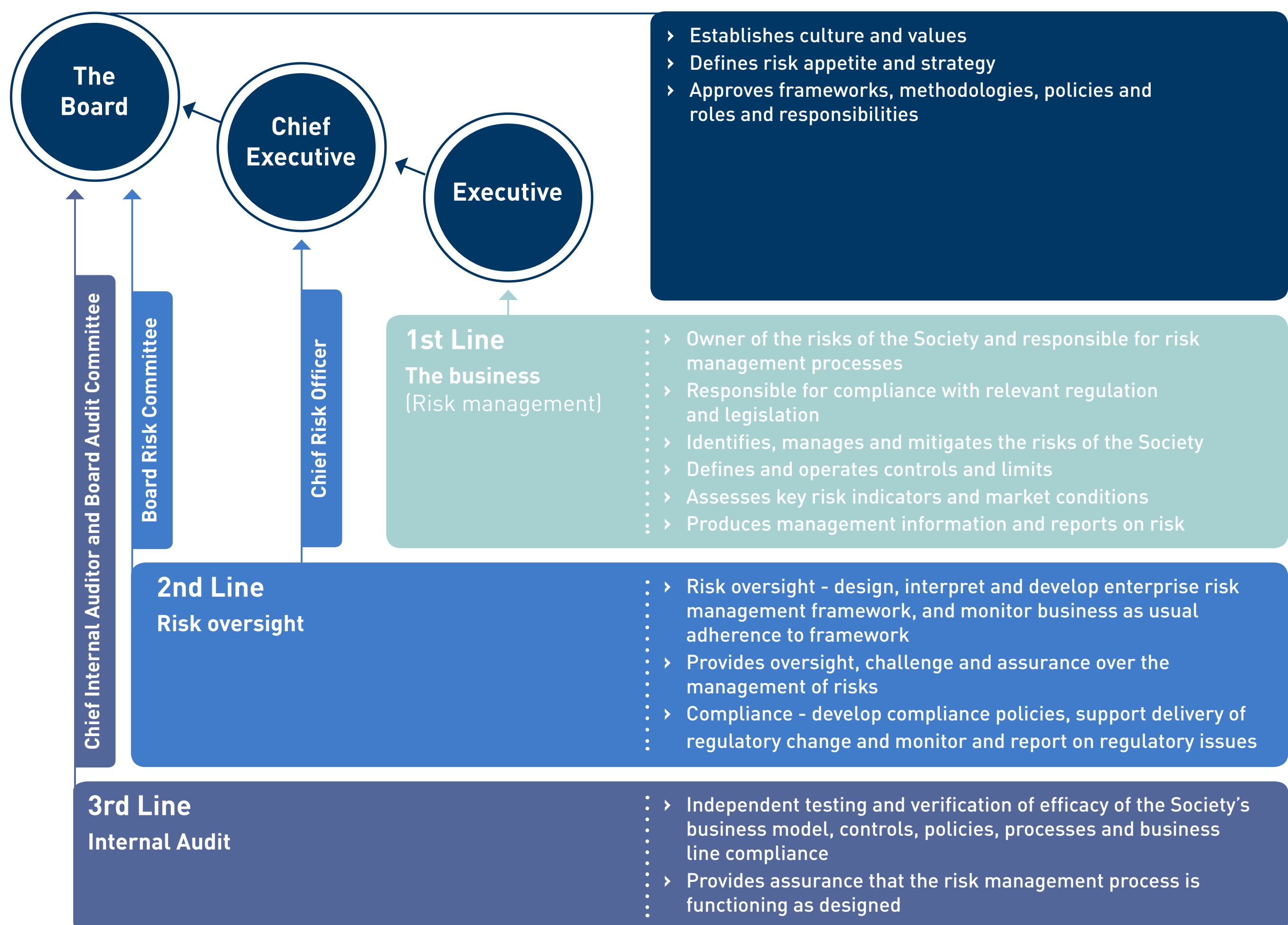
The Society's performance and adherence to Board limits is reviewed as part of a consolidated risk report by each Executive Risk Committee (ERC) and Board Risk Committee (BRC).

Three lines of defence

The Society's ERMF is structured along the 'three lines of defence' model which is recognised as an industry standard for risk management.

The structure and responsibility of management and Board Committees are set out below:

- First line of defence – risk management is primarily the responsibility of all managers and employees of the Society. Management has a responsibility to understand how risks impact their area of the business and to put in place controls or mitigating activities.
- Second line of defence – independent oversight is required to challenge managers and employees effectively in their performance of risk management activities and to provide risk management expertise. This is provided through the Risk function and Risk Oversight Committee (ROC). The Chief Risk Officer reports to the Chief Executive and has an independent reporting line directly to the Chair of BRC.
- Third line of defence – the Society's Internal Audit function is responsible for providing independent assurance including reviewing the effectiveness of the Society's risk management structure and adherence to processes. The Chief Internal Auditor has an independent reporting line directly to the Chair of the Board Audit Committee (BAC), and reports to the Chief Executive for day-to-day management. BAC approves the work programme of Internal Audit and receives reports on the results of the work performed.



Governance and control

Risk governance structure

Governance is maintained through delegation of authority from the Board, down through the management hierarchy, supported by a committee-based structure designed to ensure that risk appetites, policies, procedures, controls and reporting are fully in line with regulation, law, corporate governance and industry good practice.

As part of the implementation of the ERMF during 2015, the Society has enhanced its risk governance structure which is set out overleaf. Whilst maintaining the key principle of having a Risk Committee for each relevant risk category, the risk governance structure was enhanced to include a ROC. Chaired by the Chief Risk Officer, ROC further facilitates a comprehensive second line review of risks across all categories.

Further information on BRC is included in the Directors' Report on Corporate Governance on page 65 and on BAC in the BAC Report on pages 69 to 73.

Risk Management Report cont.

The Board

Please go to pages **60-68** for more information on the Board

Board Risk Committee (BRC)*

Chair: Non-executive Director

- Oversees and advises the Board on current and potential risk exposures to the Society including reviewing risk appetite, risk limits and tolerances across the full range of risks to which the Society may be exposed.
- Satisfies itself on the design and completeness of the Society's internal control and assurance framework relative to the risk profile.
- Seeks assurance that the Society has an effective risk governance structure.

Please go to page **65** for more information on the Board Risk Committee

Board Audit Committee (BAC)

Chair: Non-executive Director

- Reviews the adequacy of internal control and risk management processes.
- Monitors the integrity of financial statements.

Internal Audit

- Provides assurance that the risk management processes and controls are effective.

External Audit

- Independently examines and expresses an opinion on the financial statements.

Please go to pages **69-73** for more information on the Board Audit Committee

Chief Executive

Executive Risk Committee (ERC)

Chair: Chief Executive

- Ensures that risk is being identified and managed efficiently across the Society.
- Ensures that the Society's risk management framework remains effective.
- Ensures the robustness of the overall stress testing and scenario analysis programme for risks faced by the Society.

Risk Oversight Committee (ROC)

Chair: Chief Risk Officer

- Provides independent oversight of the management of risk throughout the Society and ensures that risks are identified, assessed, managed, monitored and reported effectively and consistently.

Conduct Risk and Compliance Committee (CRCC)

Chair: Chief Executive

- Oversees and monitors the Society's delivery of good customer outcomes consistent with the conduct risk appetite statement approved by the Board.

Asset and Liability Committee (ALCO)

Chair: Finance Director

- Oversees the asset and liability risks faced by the Society, specifically market risk, treasury credit risk and liquidity and funding risk.

Retail Credit Risk Committee (RCRC)

Chair: Chief Risk Officer

- Monitors the management of retail credit risk across the Society and the performance of the mortgage book and IRB models to ensure compliance with limits approved by the Board.

Operational Risk Committee (ORC)

Chair: Chief Operating Officer

- Monitors operational risk, business continuity, compliance and financial crime policy, and security risk in the Society.

* BRC has a responsibility for overseeing the effective application of the Society's risk and control framework.

Risk management

The risk management approach encompasses the requirements for identifying, assessing, managing, monitoring, escalating and reporting on risk. Techniques involved include the use of risk and control self-assessment by the first line of defence, the use of key risk indicators, risk management information, the monitoring of risks by each of the three lines of defence, risk modelling and stress testing, and planning.

The risk management processes are designed to deliver the Society's risk management objectives which at a strategic level are to:

- Identify risks to the Strategic Plan and Society objectives.
- Assess risk exposures by impact and likelihood.
- Respond to risks by evaluating them against the Society's risk appetite, formulating associated management responses and monitoring the agreed management action plans and progress.

Stress testing and planning

The Society recognises that stress testing is a key tool to understanding and managing risk. In support of this, the Society has developed and maintains a detailed stress testing framework that covers stress testing, scenario planning and contingency planning. As well as an understanding of the Society's resilience to internal and external shocks, stress testing provides a key input to the Society's capital and liquidity assessments and related tests of risk management and measurement assumptions.

The stress testing that the Society undertakes is designed to:

- Confirm the Society has sufficient capital and liquidity resources.
- Ensure the Society remains within its risk appetite.
- Ensure the alignment between the Society's risk management framework and senior management decision making.
- Provide sufficiently severe and forward looking scenarios.

ICAAP

The Internal Capital Adequacy Assessment Process (ICAAP) is the Society's evaluation of its capital position and requirements, assessed under the Capital Requirements Regulation and Capital Requirements Directive (CRD IV) framework. The ICAAP provides details of the current approaches used to manage risk across the Society. As part of that assessment, the ICAAP has to assess capital requirements both against the Society's current position and during severe but plausible stresses.

The Society bases its capital requirements on a stressed scenario specified by the regulator overlaid with further adverse second order effects. In addition, a range of other more severe stresses are considered in support of the overall capital calculation. The stresses also reflect both low and high Bank of England Base Rate scenarios.

ILAAP

The Internal Liquidity Adequacy Assessment Process (ILAAP) is the Society's documentation of its liquidity position and requirements, assessed against regulatory requirements and risk tolerance. An integral component of the approach to liquidity risk management is stress testing, some of which is prescriptive, using very detailed rules and guidance issued within prudential regulations and reported within regulatory returns. In addition to the regulatory prescribed stress testing, the Society undertakes its own stress tests and sets limits on these, which tend to be more onerous than those defined by the regulator. The Society's stress tests and regulatory returns are completed weekly, alongside a monthly operational stress and six-monthly alternative stress tests.

Reverse stress testing

Reverse stress testing informs, enhances and integrates with the Society's existing stress testing framework by considering extreme events that could 'break' the Society. As such it complements the existing ICAAP and ILAAP processes, helping to improve risk identification and risk management more generally.

The application of reverse stress testing follows two basic approaches. A qualitative approach begins with executive workshops to provide an opportunity to explore the threats and issues which may sit outside routine risk reporting. The threats identified are amalgamated with risks identified in a parallel process incorporating operational risks. The combined threats and risks are then explored to see what additional events would be required to reduce capital and liquidity buffers to critical levels and determine the feasibility of all these events occurring together. This qualitative approach is supplemented with a quantitative assessment of the risks which explores the level of capital or liquidity failure required to reduce the regulatory surplus to zero. A key outcome from the process is to consider whether any of the scenarios considered are sufficiently plausible to necessitate a change to the Society's strategy or underlying controls.

The analysis is formally undertaken every 12 months and reviewed and approved by the Board, although the scenarios are considered more frequently by the Risk function.

Risk Management Report cont.

Recovery and Resolution Plan

The regulatory authorities are keen to avoid committing more taxpayers' funds towards any failed banks and building societies and are requiring institutions to formulate plans to avoid such eventualities. The recovery section of the plan outlines what can be done to stop the Society from failing whilst the resolution section of the plan provides the data required to establish resolution options for the Society. The process of preparation for such extreme events enables the Board to plan actions it would take to recover from adverse conditions which would otherwise lead to failure. The recovery plan represents a 'menu of options' for the Society to deal with firm-specific or market-wide stresses and which can be incorporated into a credible and executable plan. As part of the annual review of the Recovery and Resolution Plan back-testing is performed to assess the credibility of the plans against stress events with the potential to cause the failure of the Society.

Top and emerging risks

Economic environment

The UK economy performed more strongly in 2015 compared with many countries in the Eurozone, but optimism remained muted amid wider concerns that the global economy is slowing. Unemployment levels continued to fall over the year although such falls seem to be levelling off. Domestic inflation has remained low, driven by cheaper commodity prices in particular that of oil. Growth in European economies looks sluggish; this is compounded by prospects of monetary policy divergence across global economies leading to exchange rate volatility.

Equity and bond markets have been volatile in the early part of 2016 following global movements and uncertainty over the timing and outcome of a 'Brexit' vote. With limited signs of inflationary pressure, expectations for base rate rises have been pushed out further, with the majority of commentators now forecasting no change in 2016.

Following disappointing economic news at the start of 2016 from China, steep falls in commodity prices, and subsequent reductions in major stock markets a slowing global economy has the potential to impact the growth in the UK economy.

Interest rate shocks

While the Society has no direct exposures to emerging economies, the impacts on the UK economy from the slowing down of China and emerging economies may create second order effects on the Society through their impact on the UK economy. There has again been significant speculation over the timing of the next Bank of England Base Rate movement, with the Bank's ability to raise rates having been hampered by the weak global economy and record low inflation, being close to zero over the past 12 months and at times negative.

The UK has now been in a prolonged flat Bank of England Base Rate environment for seven years. In its assessment of the economic environment, the Board has always taken a prudent approach to possible interest rate movements and will position the Society to protect against any adverse outcomes.

Lending markets

House prices compared with earnings are at historically elevated levels and in previous economic cycles such imbalances may have contributed to house price falls. However, affordability is being strongly supported by record low interest rates.

Whilst 2015 saw lower house price inflation compared with 2014, both the Financial Policy Committee (FPC) and more recently the Bank of England have expressed concerns in respect of buy to let lending which has been the predominant driver of the UK's positive net lending since the financial crisis. The concern is one of procyclicality; borrowers looking for capital growth are more likely to invest when house prices rise but may quickly disinvest when house prices fall exacerbating any recessionary trend. As a consequence, HM Treasury issued a consultation paper in December 2015 on additional powers to limit buy to let mortgage lending by reference to loan to value and interest coverage ratios.

Restrictions on tax relief on buy to let borrowings will be phased in from 2017. The Chancellor has also announced that stamp duty rates will rise significantly for anyone buying a home that is not their main residence – which would include buy to let investors as well as second home owners. The higher rate of duty starts from April 2016, and there has been speculation that this could lead to a rush by some would-be-landlords to buy before then which might help to push up house prices further, followed by a fall in demand. The Society will continue to maintain the high quality of its buy to let mortgage book, in which it is more restrictive on the type of lending it will undertake compared to many market participants; for example, the Society does not lend on houses of multiple occupancy and places limits on both the value of the property and the number of properties per borrower.

The Society considers the inherent risks to mortgage borrowers currently enjoying relatively low rates, who could suffer from a rate 'shock' in the event that the Bank of England Base Rate begins to rise and any consequent effects on mortgage affordability. To this end, through a thorough underwriting process, the Society only lends to those customers who it believes can afford repayments at a higher rate than is currently being charged. Regular and extensive stress testing is undertaken on the mortgage book under various scenarios, such as increased interest rates, and movements in unemployment levels and house prices.

Cyber threats

Cyber-attacks are a significant and developing risk for financial institutions across the globe, many of which have responded to this increasingly sophisticated threat through a substantial investment in technology.

The Society is determined to ensure that its defences are robust and continues to implement improvements where necessary. To support this approach, the Society has embarked on a significant exercise to update its defences and maintain an appropriate level of resilience.

Regulatory reforms

The regulatory change agenda has been demanding. The Society has continued to use its resources to identify, monitor and assess the impact of regulatory changes. The longstanding focus on Putting Members First means the Society remains committed to deliver good outcomes for members. This is consistent with the broader regulatory agenda to identify and manage Conduct Risk. Providing straightforward and competitive products is also a regulatory theme which matches our business strategy. The Society has made preparations for, and remains on track to meet, the new Mortgage Credit Directive obligations in time for the March 2016 deadline. Changes have also been made internally to comply with the Deposit Guarantee Scheme Directive requirements, including mailing all eligible deposit holders with balances above £50,000 to make them aware of changes to the Financial Services Compensation Scheme (FSCS). In addition, freephone numbers have been provided to intermediaries and members, going beyond the regulatory minimum. The reduction in the FSCS limit to £75,000 has not had a material adverse impact on liquidity resources.

More broadly in a prudential context, the FPC has played a visible role in overseeing macro-prudential financial stability in the UK. In July 2015 Parliament passed legislation granting it powers of direction over the setting of a number of affordability ratios for owner-occupier mortgages and in December 2015 the Government consulted on a proposal to extend those powers to buy to let mortgages. The Society continues to take a prudent approach to all lending, including buy to let. The Board will monitor pronouncements made by the FPC in the event that it exercises these powers in 2016.

The Prudential Regulatory Authority (PRA) implemented the FPC's direction to introduce a leverage ratio framework. Major UK banks and building societies with retail deposits of £50 billion or more, are subject to a 3% minimum requirement, plus potential buffers. In 2017, the FPC plans to review the UK framework in light of international developments, including proposals for a binding leverage ratio set at the European level which is expected to be implemented in 2018 for all UK banks and building societies.

The PRA published a consultation paper on the approach to setting minimum requirements for own funds and eligible liabilities (MREL) in December 2015. MREL will be set on an individual firm basis and the Society should be informed of its requirement in 2016. However, senior unsecured debt is not eligible and the Society, along with many of its peers, may be required to issue more capital to meet the requirements once known.

The Board also continues to monitor other regulatory developments that could lead to a significant increase in the Society's capital requirements including reviews of Internal Ratings Based modelling approaches, proposed revisions to the Standardised approach for capital requirements and the capital floor framework. Some of the proposed revisions are at a relatively early stage and the Board will seek where possible to influence the final outcome in order to ensure any changes are proportionate and justifiable.

Investment programme

The pace of technological developments and rising customer expectations is creating significant change in financial services.

In response to these challenges, the Society has commenced a four year programme that will provide members with a broader choice of products and transform the way they interact with us as well as improving internal processes and systems. The Society is therefore investing significant resources in ensuring the speed, efficiency, reliability and robustness of its IT systems and controls and their ongoing monitoring.

The undertaking of any change programme is not without risk. The Board recognises that the successful management of risks and uncertainties in the delivery of this programme is key. There will therefore be a strong focus on change governance and programme management to minimise these risks.

Strategic Report

Risk Management Report cont.

Credit risk

Credit risk is the risk that borrowers or counterparties will not meet their financial obligations to the Society as they fall due.

Maximum exposure to credit risk (Audited)

The following table presents the Society's maximum exposure to credit risk for on-balance sheet and off-balance sheet financial exposures before taking into account collateral held or other credit enhancement, and after allowing for impairment where appropriate. The maximum exposure to loss for off-balance sheet financial exposures is considered to be the contractual nominal amounts.

	On-balance sheet carrying value 2015 £m	Off-balance sheet exposures[1] 2015 £m	Maximum credit risk exposure 2015 £m	On-balance sheet carrying value 2014 £m	Off-balance sheet exposures[1] 2014 £m	Maximum credit risk exposure 2014 £m
Cash and balances with the Bank of England	2,587.8	–	2,587.8	2,114.5	–	2,114.5
Loans and advances to credit institutions	235.8	–	235.8	180.5	–	180.5
Debt securities	1,551.7	2,045.5	3,597.2	1,655.2	1,322.6	2,977.8
Loans and advances to customers	29,411.0	1,684.2	31,095.2	26,959.6	1,439.8	28,399.4
Hedge accounting adjustments	78.1	–	78.1	98.1	–	98.1
Derivative financial instruments	173.0	–	173.0	208.3	–	208.3
Total	34,037.4	3,729.7	37,767.1	31,216.2	2,762.4	33,978.6

1. Off-balance sheet exposures comprise loan commitments and unencumbered Treasury bills relating to the Funding for Lending Scheme.

Retail credit risk

Retail credit risk profile

The nature of the Society's lending has remained focused on low risk residential mortgage business, comprising owner-occupier and buy to let. The Society discontinued its modest lending on non-traditional mortgages (near-prime and self-certification) in 2008, and withdrew from offering unsecured personal loans in 2009. Activity in these areas was always limited and balances on these portfolios continue to reduce such that they now represent less than 1.4% of total gross balances. The small commercial book was part of the Stroud & Swindon portfolio that was added to the Society's overall assets upon merger of the two societies in 2010. No new commercial lending has been undertaken since 2009.

Loans and advances to customers, gross of impairment provisions, are shown below:

Loans and advances to customers (Audited)	2015 £m	2015 %	2014 £m	2014 %
Residential mortgages: owner-occupier	18,402.5	62.6	16,835.2	62.4
Residential mortgages: buy to let	10,595.9	36.0	9,657.4	35.8
Total traditional residential mortgages	28,998.4	98.6	26,492.6	98.2
Residential near-prime mortgages	95.1	0.3	105.2	0.4
Residential self-certification mortgages	291.1	1.0	331.6	1.2
Commercial mortgages[1]	4.6	–	6.3	–
Total non-traditional mortgages	390.8	1.3	443.1	1.6
Unsecured personal loans[1]	43.5	0.1	50.0	0.2
Total gross balance	29,432.7	100.0	26,985.7	100.0

1. Legacy books of unsecured personal loans and commercial mortgages. The credit risk for these is immaterial and therefore not considered further in this report.

Geographical concentration (Audited)

The residential mortgage portfolio is well diversified and reflects the national coverage of the Society's distribution channels. The geographical split of residential mortgages by balance, gross of impairment provisions is shown below:

Region	2015 %	2014[1] %
Greater London	22.8	21.8
Central England	20.5	21.1
Northern England	16.0	16.2
South East England (excluding Greater London)	24.4	24.2
South West England	9.6	9.8
Scotland	4.0	4.0
Wales and Northern Ireland	2.7	2.9
Total	**100.0**	100.0

1. Regions have been redefined and comparative numbers have been updated accordingly.

Loan to value

The Society's low risk approach to lending is reflected in the loan to value profile of the residential mortgage book. The estimated value of the residential mortgage portfolio is updated on a quarterly basis using the Nationwide Regional House Price Index.

From October 2014, the FPC introduced a 15% limit on the proportion of new lending that may be written at income multiples of 4.5 and above. This limit applies to residential mortgages, excluding buy to let. The Society does not typically lend at multiples above 4.5 and its proportion of new lending at or above this multiple has averaged only 0.7% over the year, comfortably within the FPC limit and in line with the Society's overall approach to lending.

The residential mortgage book as at 31 December 2015 is analysed below, together with an analysis of gross new lending in the year. The following tables are by value of loans unless stated otherwise:

Total mortgage book profile by number of accounts (Audited)	2015 %	2014 %
Indexed loan to value:		
< 50%	48.8	48.1
50% to 65%	24.5	25.9
65% to 75%	14.1	13.0
75% to 85%	8.7	8.8
85% to 95%	3.6	3.7
> 95%	0.3	0.5
Total	**100.0**	100.0
Average indexed loan to value of stock (simple average)	48.4	48.6
Average indexed loan to value of stock (balance weighted)	55.2	55.6

Gross lending – new business profile (Audited)	2015 %	2014 %
Owner-occupier purchase	36.6	38.2
Owner-occupier remortgages	23.2	23.3
Owner-occupier further advances	1.3	1.2
Buy to let	38.9	37.3
Total	**100.0**	100.0
Average loan to value (simple average)	63.0	63.6
Average loan to value (balance weighted)	66.1	66.3

Retail credit risk management – residential mortgages

Meeting current and future members' needs for residential mortgages remains a cornerstone of the Society's simple business model. Credit risk for the Society is therefore most likely to present itself in the potential inability of a borrower to repay their mortgage, and will materialise if that inability to repay results in repossession of the borrower's property, and subsequent loss if the value of the property upon sale is insufficient to pay the mortgage balance in full.

Risk Management Report **cont.**

Exposure to this risk is monitored and managed by a specialist department that reports to the Chief Risk Officer, and is overseen by the Retail Credit Risk Committee (RCRC). RCRC's activities and decisions are ultimately overseen by the Board via the Committee hierarchy set out on page 26.

The Board sets risk limits within the context of the Society's prudent risk appetite, and RCRC ensures the quality and mix of new lending and the overall portfolio remains within these limits. It does this by setting and monitoring lending policy and ensuring appropriate controls are in place to maintain the quality of lending, including reviewing comprehensive management information and undertaking extensive benchmarking against comparative data, which is sourced from both publically available data and via its membership of industry benchmarking groups.

There is also a comprehensive quality assurance programme that operates both during the processing of mortgage applications and post completion, to ensure continuous improvement is achieved and minimise the chances of unidentified systemic issues impacting on the quality of new lending.

To meet its objectives, the Society operates a combination of statistical modelling (credit scoring) and assessment of applications against lending policy criteria which are embedded as rules within the Society's automated decision system. This system uses information from the statistical modelling and assessment against policy rules to provide consistent lending decisions, and helps determine when manual intervention is required by skilled underwriters.

On all owner-occupier mortgage applications, the Society also assesses borrower affordability to ensure that the applicants' income, after considering key spending requirements, is sufficient to meet the mortgage payments both currently and also in a much higher (stressed) interest rate environment. This stressed affordability assessment forms part of the Society's approach to meeting its obligations as a responsible lender.

The Society considers that the risks in its buy to let portfolio are comparable or even lower than the risks in its owner-occupier portfolio. It makes this assessment after consideration of its prudent lending policy with respect to buy to let lending, which includes limiting the number of properties it will consider when lending to landlords, requiring rental properties to be readily saleable into the owner-occupier market (thereby giving recourse to two markets in the event the property is repossessed), and by applying a stressed interest rate to ensure its prudent minimum rental coverage requirements (percentage of the monthly payment covered by the rental income) can be met even in a future higher interest rate environment. This latter requirement together with prudent minimum rental income requirements also help to ensure that the borrower can accommodate periods of rental voids or the cost of unexpected repairs without undue strain on the ability to meet monthly payments as they fall due. The Society also operates at the low loan to value, high quality end of the buy to let market, which means that in the event of default, credit losses are typically low.

The Society has a natural concentration in the UK market, as it only lends on properties secured in the UK. Close monitoring of the geographical distribution of exposures, lending by distribution channel, and by type of product together with lending limits to specific segments of the market help to manage the risk of overexposure to any one region or counterparty.

Regular stress testing is undertaken on the mortgage book which seeks to establish the extent to which losses may emerge under a range of macroeconomic and specific stress scenarios and to ensure that the Society continues to remain within its retail credit risk appetite. These stress tests primarily translate a range of economic variables such as interest rates, unemployment rates, and house price movements into estimates of default rates and loss severity, and the consequent impact on impairment losses and capital consumption.

The Society places great emphasis on working with existing borrowers who experience financial difficulty on an individual basis, and to consider each case of financial hardship on its own merits, where it affects the borrower's ability to make their mortgage payments. Reasonable and realistic arrangements are sought, based on what the customer can afford, provided there is a high degree of confidence that any missed payments will be repaid over a reasonable timeframe. This work is undertaken by a specialist department. Forbearance remains one of the tools at the disposal of this department, and more information on the extent and type of forbearance offered by the Society is given later in this section. The work undertaken by the specialist department is overseen by RCRC, which monitors arrears performance and sets arrears policy in accordance with the objective of treating customers fairly and within the Society's overarching Putting Members First philosophy.

Repossession of a property is only sought where all reasonable efforts to regularise matters and repay missed mortgage payments have failed, or where the mortgage is unsustainable in the longer-term.

Regular reviews of the Society's arrears management function and processes are independently undertaken to ensure that borrowers are being treated fairly, appropriately and sympathetically and in line with established policies and procedures, and regulatory guidance. Where shortcomings are identified, action plans are put in place to rectify the issues. These are monitored and closure is subject to independent oversight.

Identifying impaired loans (Audited)

Loans are categorised by arrears status in line with industry practice and are identified as being either not past due and not impaired (if up to date at the balance sheet date), past due up to three months but not impaired, or impaired if more than three months in arrears or in possession.

In terms of impaired mortgages, the Society's performance is compared with figures published by the Council of Mortgage Lenders (CML). From these figures it can be seen that the performance of the Society has remained strong, with arrears reducing over the year, and favourable to the industry.

The Society's number of accounts in arrears as a percentage of loans and advances to customers compared with the CML data is shown below:

(Audited)	2015 Society %	2015 CML[1] %	2014 Society %	2014 CML[1] %
Greater than three months	0.45	1.12	0.68	1.33
Greater than six months	0.17	0.62	0.26	0.70
Greater than one year	0.05	0.27	0.08	0.28
In possession	0.01	0.03	0.02	0.06

1. Council of Mortgage Lenders' data as at 31 December 2015 (31 December 2014).

An analysis of past due and impaired loans by loan to value is shown below:

As at 31 December 2015 (Audited)	Not impaired		Impaired				
Indexed loan to value:	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
< 50%	10,945.7	106.1	18.3	8.4	–	(3.4)	11,075.1
50% to 65%	8,522.1	91.9	19.9	12.4	0.1	(3.8)	8,642.6
65% to 75%	5,034.6	54.4	13.6	9.8	0.3	(2.0)	5,110.7
75% to 85%	3,155.5	45.1	10.3	8.4	0.1	(1.7)	3,217.7
85% to 95%	1,182.5	22.9	8.2	5.8	0.5	(1.6)	1,218.3
> 95%	85.6	11.7	5.0	5.6	4.4	(4.8)	107.5
Unsecured	39.5	3.3	0.4	0.3	–	(4.4)	39.1
Total	28,965.5	335.4	75.7	50.7	5.4	(21.7)	29,411.0

As at 31 December 2014 (Audited)	Not impaired		Impaired				
Indexed loan to value:	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
< 50%	9,697.5	97.3	24.3	10.9	0.1	(3.7)	9,826.4
50% to 65%	8,324.8	92.7	28.3	16.6	0.2	(4.3)	8,458.3
65% to 75%	4,228.2	62.4	19.9	15.5	0.4	(2.7)	4,323.7
75% to 85%	2,871.0	50.7	14.9	13.3	0.2	(3.0)	2,947.1
85% to 95%	1,140.5	28.5	15.1	11.7	0.9	(2.8)	1,193.9
> 95%	131.6	15.2	8.4	8.7	5.9	(5.2)	164.6
Unsecured	45.6	3.5	0.6	0.3	–	(4.4)	45.6
Total	26,439.2	350.3	111.5	77.0	7.7	(26.1)	26,959.6

The Society held properties valued at £4.0 million (2014: £6.4 million) pending their sale against balances of £3.7 million (net of provisions) (2014: £5.8 million). Shortfalls between expected sale proceeds (less anticipated costs) and the balance outstanding are fully provided.

Strategic Report

Risk Management Report **cont.**

The table below provides further information regarding the impaired status of mortgages and loans. Balances are shown gross of impairment provisions.

As at 31 December 2015 (Audited)	Not impaired		Impaired				
	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
Residential mortgages							
Owner-occupier	18,097.9	217.9	52.0	32.1	2.6	(7.1)	18,395.4
Buy to let	10,516.2	64.7	6.7	6.7	1.6	(7.7)	10,588.2
Non-traditional mortgages							
Residential near-prime	56.5	22.8	9.1	6.3	0.4	(0.5)	94.6
Residential self-certified	251.3	26.2	7.5	5.3	0.8	(1.2)	289.9
Commercial lending	4.1	0.5	–	–	–	(0.8)	3.8
Unsecured	39.5	3.3	0.4	0.3	–	(4.4)	39.1
Total	28,965.5	335.4	75.7	50.7	5.4	(21.7)	29,411.0

As at 31 December 2014 (Audited)	Not impaired		Impaired				
	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
Residential mortgages							
Owner-occupier	16,484.3	223.1	73.6	51.6	2.6	(9.0)	16,826.2
Buy to let	9,562.9	69.9	13.1	9.4	2.1	(9.5)	9,647.9
Non-traditional mortgages							
Residential near-prime	57.9	22.7	14.1	9.2	1.3	(1.1)	104.1
Residential self-certified	283.1	30.3	10.1	6.4	1.7	(1.3)	330.3
Commercial lending	5.5	0.8	–	–	–	(0.8)	5.5
Unsecured	45.5	3.5	0.6	0.4	–	(4.4)	45.6
Total	26,439.2	350.3	111.5	77.0	7.7	(26.1)	26,959.6

Movement in impaired loans

The table below reconciles the movements in impaired loans in the year:

As at 31 December 2015 (Audited)	Traditional residential mortgages		Non-traditional mortgages				
	Owner-occupier £m	Buy to let £m	Residential near-prime £m	Residential self-certified £m	Commercial lending £m	Unsecured £m	Total £m
Impaired at 1 January 2015	127.8	24.6	24.6	18.2	–	1.0	196.2
Classified as impaired during the year	93.1	26.8	21.9	19.7	0.1	1.0	162.6
Transferred from impaired to unimpaired	(120.8)	(32.6)	(28.7)	(23.0)	(0.1)	(0.5)	(205.7)
Amounts written off	(0.7)	(0.6)	(0.3)	(0.3)	–	(0.2)	(2.1)
Charged to impaired loans	1.4	0.5	0.4	0.3	–	–	2.6
Repayments and other movements	(14.1)	(3.7)	(2.1)	(1.3)	–	(0.6)	(21.8)
Impaired at 31 December 2015	86.7	15.0	15.8	13.6	–	0.7	131.8

Loan balances are shown gross of provisions. Amounts written off reflect losses on properties sold from possession where the balances on these loans were in excess of the sale proceeds. Repayments and other movements include disposals (sale proceeds from properties in possession), and repayments (from customers reducing the outstanding balances). Amounts charged to impaired loans include interest accrued and charges. The movement in impairment provisions on loans and advances to customers is further detailed in note 10 to the accounts.

Extent and use of forbearance (Unaudited)

The Society will always seek to work with existing borrowers who experience financial stress to arrive at a mutually acceptable, sustainable solution. The exercising of forbearance will be considered if it is in the best interests of both the borrower and the Society to do so, and it represents a viable means of regularising the mortgage and helping borrowers manage their financial difficulties in a sustainable manner.

Should borrowers find themselves in financial difficulty resulting in arrears, the Society will seek to help and work with them on a case by case basis to resolve matters subject to the mortgage being put back on to a sustainable footing in the longer-term.

The principal forbearance measures provided by the Society on arrears cases are as follows:

- Arrangements, where monthly payments are maintained and the arrears are repaid over a period of time.
- Concessions, where it is agreed to accept the normal monthly payment, reduced payments, or in exceptional circumstances no repayments for a short period.
- Mortgage term extensions to reduce the amount of the monthly payment may be considered as part of a longer-term solution, provided that payments will be sustainable over the life of the mortgage.

In very rare cases, the Society may consider capitalisation of arrears or putting the mortgage, if on a repayment basis, on to an interest only scheme for a temporary period.

Capitalisation will only be considered once during the lifetime of the mortgage and only where the customer has made at least six consecutive monthly payments, and it has been determined that the level of payment required post capitalisation is both affordable and sustainable in the long-term. In 2015 the Society capitalised arrears on 6 accounts (2014: 25).

Where the case is not in arrears, the most common means of exercising forbearance as a means of helping borrowers overcome temporary financial difficulties is by granting a short-term payment holiday. Whilst payment holidays are a feature of most products offered by the Society, where it has been determined that financial difficulties are the reason for the request, the action is recorded as being a forbearance measure rather than as one where the borrower is utilising the product feature.

Details of forbearance activity are set out in the table below:

	2015 No. of accounts	2015 Carrying value £m	2014 No. of accounts	2014 Carrying value £m
Forbearance: Accounts past due				
Arrangements	1,754	196.0	2,355	266.4
Concessions	64	6.2	109	11.9
Term extensions[1]	10	1.4	15	1.6
Capitalisation of arrears[1]	1	0.2	3	0.3
Temporary transfer to interest-only[1,2]	–	–	1	0.1
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	762	88.7	1,152	138.6
Term extensions[1]	61	9.4	52	6.7
Capitalisation of arrears[1]	5	0.4	22	3.2
Temporary transfer to interest-only[1,2]	–	–	3	0.4

1. Granted in the last 12 months.
2. The option to transfer members to temporary interest-only payments is only used in very rare situations.

Risk Management Report **cont.**

The number of accounts in the various forbearance categories has fallen compared with the previous year end reflecting the improving economic environment and improved credit risk profile of the Society's borrowers. Whilst accounts not past due are not considered to be individually impaired, it is recognised that collectively impairment exists. Provisions have therefore been raised against accounts subject to a forbearance measure (see note 10 to the accounts), totalling £4.7 million (2014: £6.8 million) for all cases in these forbearance categories.

In addition the Society has identified the following situations as indicating potential impairment amongst members whose mortgages are nonetheless not past due:

- Accounts where direct debits had been cancelled or returned but payment was subsequently made.
- Payments being made by the Department for Work and Pensions.
- The Society has paid ground rent on behalf of members living in leasehold properties.

Members whose mortgage accounts display these potential impairment indicators have a higher than expected propensity to go into arrears, but the increased propensity is not so high as to consider these loans as being individually impaired.

The analysis of these potential impairment indicators demonstrates the performance of any mortgage that has had one of these situations arise in the previous 12 months. As at 31 December 2015, there were 2,218 members with such potential impairment indicators, to the value of £221.0 million (0.75% of the mortgage book). A collective provision of £0.1 million is being held, which reflects the low probabilities of default (since 31 December 2014, only 8 cases in these categories have gone into arrears by six or more months) and high collateral values (the average simple loan to value is 44.1% and only 24 cases are above 95% loan to value) of these mortgages.

The Society has systems in place to collect information on all requests by borrowers for changes to the terms and conditions of their mortgage, and is tracking the performance of these changes over time to determine if there are further incidences of potential impairment that are not immediately evident at the time of the request. Examples of the types of changes include changes to payment date or method, drawdown requests (where allowed for by the product), and requests for permission to temporarily let the (owner-occupier) borrower's property. Currently there is no objective evidence that, following these changes, higher default rates have resulted that would lead us to conclude that additional provision for these cases was appropriate.

Outlook

The Society continues to focus its lending on low loan to value business to protect it from loss, and assesses affordability under a higher interest rate environment to protect the borrower. The Society is nonetheless alive to the possibility that interest rate rises will place borrowers under additional strain and has undertaken analysis to understand the vulnerabilities faced by its borrowers in the event of interest rates increasing. In 2015, the Society proactively contacted borrowers most at risk with the aim of raising awareness amongst them and to provide reassurance that the Society will continue to support them if financial difficulties do arise. In this way the Society seeks to protect its members' interests whilst at the same time helping to mitigate the scale of adverse impacts on the financial performance of the Society.

While the Society anticipates that any rate rises will initially at least be gradual, it undertakes stress testing as part of its strategic planning process, and is prepared for much more rapid rises should they materialise. Stress testing also examines the potential impact of adverse movements in unemployment rates, house prices, and other macroeconomic indicators on the performance of the mortgage book.

Treasury credit risk

Management of treasury credit risk

Credit risk within the Treasury function (wholesale credit risk) arises from the portfolio of liquid and other financial assets held, and represents the risk that counterparties will fail to repay amounts when due. The Society has a low appetite for this form of risk. As such, exposures are restricted to good quality counterparties with a low risk of failure, and limits and exposures are set accordingly.

Treasury exposures and limits are focused in the main on UK institutions, with additional limits extended to a small number of highly rated banks in Europe and other developed economies such as Australia and Canada. Limits are set in line with a Board approved wholesale credit policy, which sets maximum limits taking into account internal analysis, external credit ratings, country of domicile and any other relevant factors. All credit limits require Board approval, and are subject to an initial assessment of the creditworthiness of the counterparty, with the approved limit then subject to at least an annual review. Exposures are reviewed on a daily basis to ensure that they remain within the approved limits.

Ongoing developments with treasury counterparties are closely monitored, and are reported to, and reviewed by the Treasury Credit Committee. This Committee meets weekly and is chaired by the Chief Risk Officer. The Committee is empowered to take immediate action to reduce or suspend limits where this is warranted by adverse changes in the creditworthiness of counterparties or market or local developments. The Committee reports through the Asset and Liability Committee (ALCO) to the Board via the Committee structure set out on page 26.

Derivatives are only executed with organisations that have a Board approved credit limit, and the vast majority include arrangements requiring that any movement in the value of the derivative be offset by the placing of cash collateral to reduce the resulting credit exposure on a weekly basis.

As part of its liquidity management, the Society also enters into sale and repurchase (repo) transactions where highly rated assets such as gilts are sold with an agreement to repurchase at an agreed price on a later date. The cash received may be less than the market value of the asset, creating a credit exposure. Any subsequent market movements in the value of the asset will alter this exposure and is therefore subject to daily collateralisation to mitigate this position. All repo counterparties are subject to review by the Treasury Credit Committee and are ultimately approved by the Board.

The Society has no exposure to emerging markets, hedge funds, non-UK Residential Mortgage Backed Securities (RMBS), non-UK covered bonds or credit default swaps and in excess of 99% of exposures have an investment grade rating.

Treasury liquid assets profile (Audited)

The Society's treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions, debt securities, and Treasury bills drawn under the Funding for Lending Scheme (FLS). Analysis of the Society's treasury assets by credit rating is set out below:

	Exposure value by Moody's rating				
2015 (Audited)	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	5,866.0[2]	–	–	–	5,866.0
Multilateral development banks (supranational bonds)	35.1	–	–	–	35.1
Financial institutions	113.5	316.1	13.1[3]	4.5	447.2
Mortgage backed securities	68.7	3.8	–	–	72.5
Total	6,083.3	319.9	13.1	4.5	6,420.8

	Exposure value by Moody's rating				
2014 (Audited)	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	4,652.9[2]	–	–	–	4,652.9
Multilateral development banks (supranational bonds)	70.5	–	–	–	70.5
Financial institutions	122.2	202.3	113.7[3]	1.7	439.9
Mortgage backed securities	105.0	4.5	–	–	109.5
Total	4,950.6	206.8	113.7	1.7	5,272.8

1. Unrated institutions comprise a single credit support annex in relation to a derivative liability with an unrated bank (£2.8 million) (2014: £nil) and a building society (£1.7 million) (2014: £1.7 million).
2. Balance includes the off-balance sheet Treasury bills of £2,045.5 million (2014: £1,322.6 million) drawn under the Bank of England's FLS.
3. Credit Support Annexes (CSAs) in relation to derivative liabilities.

Risk Management Report **cont.**

The following table summarises the Society's exposure to institutions split by geographic domicile:

	Liquid assets					Of which, debt securities		
2015 (Audited)	Sovereign £m	Supranational £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	5,866.0[1]	–	383.2	72.5	6,321.7	3,469.2	92.8	3,562.0
Denmark	–	–	10.4[2]	–	10.4	–	–	–
France	–	–	20.1[2]	–	20.1	–	–	–
Germany	–	–	14.5[2]	–	14.5	–	–	–
Switzerland	–	–	17.3[2]	–	17.3	–	–	–
Supranational[3]	–	35.1	–	–	35.1	35.1	–	35.1
Australia	–	–	0.7[2]	–	0.7	–	–	–
Canada	–	–	1.0[2]	–	1.0	–	–	–
Total	5,866.0	35.1	447.2	72.5	6,420.8	3,504.3	92.8	3,597.1

	Liquid assets					Of which, debt securities		
2014 (Audited)	Sovereign £m	Supranational £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	4,652.9[1]	–	424.1	109.5	5,186.5	2,790.6	116.7	2,907.3
Denmark	–	–	3.4[2]	–	3.4	–	–	–
France	–	–	4.3[2]	–	4.3	–	–	–
Germany	–	–	1.4[2]	–	1.4	–	–	–
Switzerland	–	–	6.4[2]	–	6.4	–	–	–
Supranational[3]	–	70.5	–	–	70.5	70.4	0.1	70.5
Canada	–	–	0.3[2]	–	0.3	–	–	–
Total	4,652.9	70.5	439.9	109.5	5,272.8	2,861.0	116.8	2,977.8

1. Balance includes the off-balance sheet Treasury bills of £2,045.5 million (2014: £1,322.6 million) drawn under the Bank of England's FLS.
2. Credit Support Annexes (CSAs) in relation to derivative liabilities.
3. Supranational relates to amounts held with the European Investment Bank, which is guaranteed by a number of European sovereigns.

Credit risk mitigation

Debt securities are generally unsecured with the exception of securitisation and covered bond positions which are secured by pools of financial assets.

The Society has entered into International Swaps and Derivatives Association (ISDA) master netting agreements for all of its derivatives (other than swaps undertaken by Coventry Building Society Covered Bonds LLP), whereby outstanding transactions with the same counterparty can be settled 'net' following a default or other predetermined event. Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements which typically provide for the exchange of collateral on a weekly basis to mitigate net mark to market credit exposures.

Coventry Building Society Covered Bonds LLP undertakes each swap it executes under a separate ISDA agreement. Each agreement includes a CSA which either provides for full collateralisation of the swap, or for full collateralisation when the counterparty bank credit rating falls below a certain threshold. Substantially all of the net derivative credit exposure in the following table relates to this latter arrangement. The counterparty has a credit rating of Aa2.

The Society has entered into Global Master Repurchase Agreements for all of its repo transactions. These are legal agreements that cover the terms of transactions between the two parties, including standard provisions that are generic to the market. One such provision covers the requirement for both parties to enter into an exchange of collateral. For the Society, this is calculated on a daily basis to mitigate against net exposure arising from changes in market value.

Counterparty credit risk – derivative financial instruments (Audited)

Counterparty credit risk includes the risk of default of a counterparty to such a derivative instrument. All counterparties are subject to credit assessments. All of the Society's derivatives are currently over-the-counter (OTC) (i.e. bilateral arrangements not cleared through a third party regulated institution). The balance sheet net credit exposure values of derivative instruments are given in the following table:

(Audited)	2015 Exposure value £m	2014 Exposure value £m
Gross positive fair value of contracts	173.0	208.3
Netting benefits	(106.9)	(125.8)
Net credit exposure	66.1	82.5
Collateral held	(24.2)	(39.5)
Net derivative credit exposure	41.9	43.0

As at 31 December 2015, all counterparties with whom the Society has a net derivative credit exposure had a Moody's credit rating of Aa3 or above. The derivative exposure can only be settled net following a default or other predetermined event, and therefore there is no right of set-off in the balance sheet.

Impairment provisions: Available-for-sale assets

Unrealised gains and losses arising from changes in fair values are recognised directly in the Available-for-sale (AFS) reserve, except for impairment losses and foreign exchange gains and losses, which are recognised in the Income Statement. Gains and losses arising on the sale of AFS assets, including any cumulative gains or losses previously recognised in the AFS reserve, are recognised in the Income Statement.

When a decline in the fair value of an AFS financial asset has been recognised directly in equity reserves and there is objective evidence that the asset is impaired, accounting standards require that the cumulative loss recognised in equity reserves be removed and recognised in the Income Statement. In assessing impairment, the Society considers the credit ratings of the counterparties and current market valuations (such as negative fair value adjustments) as well as the extent to which coupon payments have been made on a timely basis. As at 31 December 2015 no amounts in the treasury portfolio were either past due or impaired, and as such no provision has been made.

Outlook

Global growth has been muted since the onset of the financial crisis. Whilst certain economic data in the UK and USA suggests a modest recovery, the situation in most of Europe, and in many emerging economies is proving more difficult, with a slowdown in China and a fall in commodity prices, particularly oil. Central banks globally are providing liquidity to the banking system through asset purchase schemes, and maintaining low or in some cases negative interest rates in an attempt to generate growth and reduce deflationary pressures.

The ongoing uncertainties support the Society's consistently cautious approach to credit risk in its Treasury operations.

The European Markets and Infrastructure Regulations (EMIR) introduce a requirement to clear derivatives through a third party regulated institution (a central clearing counterparty) to reduce systemic and operating risk. It is anticipated that the Society will become subject to mandatory clearing from the fourth quarter in 2016 and this will reduce counterparty risk for all participants.

Market risk

Management of market risk

Market risk is the risk that the amount of net income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign exchange rates. Market risk only arises in the banking book as the Society does not have a trading book, and is mainly related to interest rates as the Society has an immaterial foreign currency risk exposure. The Society does not trade or take speculative positions in derivatives.

Risk Management Report **cont.**

The Society's policy is to manage its exposure to these risks within prudent limits. It does this through a combination of matching assets and liabilities with offsetting interest rate or exchange rate characteristics and by the use of derivative financial instruments such as interest rate swaps, cross currency interest rate swaps, equity release swaps and foreign exchange contracts.

Control of market risk exposure is overseen by ALCO, and ultimately the Board via the Committee hierarchy set out on page 26. The accounting policy for derivatives and hedge accounting is described in the accounting policies in note 1 to the accounts.

Interest rate risk (Audited)

Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings because of differences between interest rates received and paid on mortgages and deposits respectively.

For example, where the Society has issued fixed rate mortgages, the risk is that a general increase in interest rates would leave the Society facing higher interest expense on its funding, but without a compensating increase in interest income. Where the opportunity exists, the Society will offset assets and liabilities with similar interest features. Alternatively the Society may take out an interest rate swap with a counterparty bank under which the Society's fixed rate income is exchanged for one based on a variable rate which would be expected to follow the general pattern of interest rate movements and thereby reduce the Society's exposure.

This risk increases with the term of the asset and is particularly relevant for equity release mortgages (£298.1 million) held by the Society; however, approximately £146.0 million of this balance is hedged, while the remainder is matched against reserves. Similarly, in cases of issuing fixed rate savings products, the Society may take out an interest rate swap under which it receives a fixed rate of interest and pays a variable rate.

The Society also continues to ensure that it has a significant proportion of discretionary variable rate savings and mortgages on its balance sheet, which has given it flexibility to manage a prolonged low interest rate environment, or the impacts from a Bank of England Base Rate rise or fall.

The Society has a series of Board approved limits that ensure the impact of a change in general interest rates has limited effects on both the net interest income generated and present value (PV) of its balance sheet re-pricing gaps. In addition, the Society forecasts monthly the impact of movements in the Bank of England Base Rate on the Society's net interest income to ensure any potential adverse impact can be anticipated.

The following tables show the impact of a 200 basis points parallel shock to interest rates on the value of the assets and liabilities (PV200) and net interest income (200 basis points) throughout the reporting period. As part of these calculations, there are a series of assumptions concerning prepayment of loans of different terms. These assumptions are based on historical prepayment profiles. In addition, it is assumed that non-maturing deposits, which do not have any specific re-pricing terms in the PV200 analysis, maintain a stable balance. These assumptions are periodically reviewed and subject to independent oversight by the Society's Prudential Risk & Compliance function.

Shock applied	+200bps 31 Dec 2015 £m	+200bps 31 Dec 2014 £m
PV200 results	(1.7)	(13.7)

	+200bps 2015 £m	-200bps 2015 £m	+200bps 2014 £m	-200bps 2014 £m
Impact on profit and loss	43.7	(10.4)	30.9	(8.3)

The PV200 measures the impact of a rate change on the value of the assets and liabilities and incorporates an approved duration for the investment of reserves by the Board. The impact on profit and loss reflects the changes in interest income on the assets and liabilities and the expected consequential effects that would occur (such as changes in customer behaviour) over the accounting period following a rate shock. In a low interest rate environment, interest rates are floored at zero. The reported sensitivity will vary over time due to strategic changes to the balance sheet mix and general market conditions and should not be considered predictive of future sensitivity.

Basis risk

Variable rate instruments may also cause interest rate risk where the underlying basis of the rate differs from the prevailing variable rate of the balance sheet. The risk is driven by market influences on the different basis which may not operate in an equal manner, creating uneven changes in the rates (e.g. Bank of England Base Rate, LIBOR and SONIA). This risk is characterised as basis risk and is measured by applying to the financial forecast an uneven change to different variable rates i.e. a basis spread shock. This includes behavioural assumptions and current business plans but excludes the impact of any consequential response.

The Board has defined limits for the level of reduction in net interest income each quarter that could arise from the basis shock applied.

Swap spread risk

In order to diversify its liquidity holdings the Society holds a part of its liquidity portfolio in gilts, which have associated derivatives (swaps), in order to hedge the interest rate risk. The hedging undertaken to mitigate interest rate movements (which follow the swap curve) will provide some protection against offsetting movements in the value of the gilts (which follow the Government securities curve). However, the credit element of gilt value movements arising from perceptions of sovereign quality remains unprotected and it is this which creates 'swap spread risk'. This risk only crystallises if the gilts are sold. Generally they are held to term as part of the Society's liquidity resources; however, under CRD IV the net difference is deducted from capital as part of the Available-for-sale reserve. Swap spread risk is monitored against a Board limit.

Product option risk

Prepayment risk is a category of product option risk, sometimes referred to as a behavioural risk, which arises from product features available to the Society's members.

Members have the option, albeit sometimes with charges, to reduce their mortgage loan (full or partial prepayment) or withdraw their savings at their discretion, representing prepayment or repayment risk to the Society. These risks are managed through a combination of the following:

- Redemption charges on mortgage products and withdrawal charges on savings products to reflect the risk.
- Offering products whose behaviour may be more predictable under the anticipated future interest rate outcomes.
- Monitoring past trends and stress testing future forecasts.
- Matching hedging to the expected attrition profile of the product.
- Balance tracking hedges for equity release mortgages.

Product option risk also includes pipeline risk – the risk that between the point of application for a product and completion, customers choose not to take the product. If this potentially occurs during a period in which interest rate expectations may have moved, this could leave the Society with an imbalance of funding or hedging that is no longer at prevailing interest rates.

The risk is managed by restricting allocations to individual products and undertaking hedging activity whilst applications are received. The risk is further mitigated by keeping the pipeline small compared with the overall balance sheet and through close monitoring during early product stages.

Concentration risk

One particular type of concentration risk is the risk arising when the quantity of retail or wholesale assets or liabilities re-pricing within a specified period reaches a size that means the Society is exposed to the risk of loss if interest rates reset at abnormally high or low rates. The risk is managed through ALCO limits on the size and time period for exposures resetting at money market rates, as well as separate limits on the concentration of maturing fixed rate mortgages and savings.

Foreign currency risk (Audited)

Foreign currency risk arises as a result of the Society's activities in raising funds and making investments in foreign currencies. This is primarily undertaken to ensure wholesale funds are obtained cost-effectively across a wide pool of potential providers, but exposes the Society to the risk of an appreciation in the value of foreign currency denominated liabilities or a deterioration in the value of the foreign currency denominated assets if exchange rates change.

The Society has a very low risk appetite for foreign currency risk and manages this through the use of currency swaps and foreign currency forward contracts. The Society also offsets foreign currency liabilities with foreign currency assets where appropriate. After taking into account the effects of cross currency swaps, the Society has no material net exposure to foreign exchange risk fluctuations or changes in foreign currency interest rates.

Redenomination risk

Redenomination risk is the risk that in the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent). The Society has minimal redenomination risk, as all euro denominated asset exposures are held with UK institutions.

Risk Management Report **cont.**

Outlook
The Board anticipates a steadily increasing Bank of England Base Rate over the next few years, with incremental rises expected potentially to begin in 2016 but more likely beyond. While the Board is comfortable that it has the necessary options to manage through a protracted low rate environment, the balance sheet is positioned to take advantage of a rising rate environment should the economy support such a rise.

Liquidity and funding risk

Strategy
The Society has a strong and diversified funding base and continues to be predominantly funded by retail savings, reflecting its long-term strategy and traditional building society model.

Retail funding consists of a mix of variable rate products, fixed rate bonds and ISAs. The Society has a strong record of attracting and retaining savings balances and continues to organically grow its savings book.

Wholesale funding is used to provide diversification by source and term, and value to members through lowering the overall cost of funding. The Society continues to retain access to wholesale funding markets. Bank of England programmes such as the FLS facility have been accessed to ensure that borrowing members are not disadvantaged and to manage liquidity and funding risk. The Society's policy is to hold sufficient quality and quantity of liquidity to withstand a severe, but plausible, combined market-wide and Society-specific stress that would last for a three month period. In addition the Society is obliged to meet regulatory requirements set by the PRA.

Liquidity resources
Liquidity risk for all subsidiaries is managed centrally by the Society and covers liquidity requirements throughout the Group. Liquidity risk is managed principally by holding funds in cash accounts and other easily realisable liquid assets. Bank of England approved mortgage portfolios, self-issued covered bonds and self-issued RMBS notes are also retained to enable access to the Bank of England's liquidity facilities. These assets are termed 'contingent liquidity'.

Liquidity risk is managed through four different categories of resources reflecting different features and the time taken to convert the resource into cash. Separate limits are applied to each category. All liquidity is held for the principal purpose of meeting expected and unexpected cash flow requirements subject to the Society's defined tolerance. The amount of liquidity held in each category is principally managed with regard to the requirements derived from internal risk based measures and regulatory requirements. In addition, treasury credit risk, encumbrance associated with the liquidity and the cost of holding such liquidity are also considered. The amount of the requirement is regularly updated and varies in line with business activity, in particular with the timing of retail and wholesale bond maturities.

The Society's liquidity resources at 31 December 2015 are set out in the table below, split by the four key categories. This table is not a representation of the accounting balance sheet as it includes encumbered Treasury bills drawn under the FLS which are not recognised on the balance sheet and excludes any encumbered assets such as cash held in the Society's covered bonds and RMBS programmes and balances posted with counterparties as collateral under swap agreements.

	Notes to the accounts[1]	2015 £m	2014[2] £m
i. Balances with the Bank of England	12	2,343.6	1,871.2
ii. UK Government securities and other qualifying securities			
Securities – on-balance sheet[3]	14	553.5	744.2
Securities – FLS Treasury bills[3]	14	1,142.2	616.3
Sub-total categories (i) and (ii)		4,039.3	3,231.7
iii. Other securities (on-balance sheet[3])	14	74.1	151.3
iv. Bank of England approved mortgage portfolios, self-issued covered bonds and RMBS4	15	3,588.1	4,323.3
Total		7,701.5	7,706.3

1. Refer to notes to the accounts for reconciliation to on-balance sheet liquid assets.
2. Following the introduction of new liquidity requirements in the year (see page 43) there are some small definitional differences in the make-up of the various categories below. As none of these are significant, comparatives numbers have not been restated.
3. Market value.
4. Nominal value of Notes and mortgage portfolio. Total amount of asset collateral is £3,622.0 million (see page 46).

i. The first category consists of cash held at the Bank of England. All of this is held in sterling.
ii. The second category comprises highly rated debt issued by the UK Government, PRA approved multilateral development banks and certain other qualifying debt securities. The second category of liquidity is held entirely in sterling. The sum of categories (i) and (ii) represent the most liquid assets held by the Society and equate to the measure of liquidity resources used in the calculation of the Liquidity Coverage Ratio (LCR) (see below).
iii. The third category consists of other liquid assets where the Society can be reasonably certain that they could be realised in a liquidity stress. Most of the liquidity is held in sterling with £9.8 million held in euros to match in part a euro denominated wholesale debt issuance.
iv. The fourth category consists of approved portfolios of mortgage collateral that could be used to access Bank of England liquidity facilities and self-issued covered bonds and RMBS that could be used in Bank of England facilities or sold to and repurchased from third parties under repo agreements.

The amount of liquidity resources held is also subject to regulatory requirements set by the PRA. At 31 December 2015, and throughout the year, the Society complied in full with the liquidity requirements that were in force.

CRD IV contains requirements on liquidity and stable funding based on the principles issued by the Basel Committee on Banking Supervision. These include the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR):

- Liquidity Coverage Ratio (LCR) – a 30 day short-term liquidity measure that came into effect from 1 October 2015. The PRA set a minimum requirement of 80% from October 2015, rising to 90% in 2017 and to 100% thereafter from 1 January 2018. The Society monitors compliance against this measure on a daily basis and as at 31 December 2015, the Society's LCR was 141%.
- Net Stable Funding Ratio (NSFR) – a measure of stable funding. This is currently expected to be implemented from 2018. The Society continues to monitor its position relative to the anticipated requirement of the NSFR. Based on its current interpretation, the Society holds sufficient stable funding to meet the new requirement.

Wholesale funding

An analysis of the Society's wholesale funding is set out in the table below:

	Notes to the accounts	2015 £m	2015 %	2014 £m	2014 %
Deposits from banks, including repo agreements	23	1,809.9	28.6	1,479.0	26.4
Other deposits and amounts owed to other customers		809.5	12.8	459.8	8.2
Debt securities in issue	24				
Certificates of deposit		87.7	1.4	3.0	0.1
Medium-term notes		1,617.4	25.5	1,687.6	30.1
Covered bonds		1,787.4	28.2	1,660.6	29.6
Residential Mortgage Backed Securities		224.1	3.5	314.3	5.6
Total		6,336.0	100.0	5,604.3	100.0

In March 2015, the Society issued a £500 million five year floating rate covered bond, which replaced a maturing bond, and later in the year raised an additional £150 million from the same issuance.

The currency analysis of wholesale funding outstanding at the end of 2015 was:

	GBP £m	EUR £m	Total £m
Deposits from banks, including repo agreements	1,809.9	–	1,809.9
Other deposits and amounts owed to other customers	809.5	–	809.5
Debt securities in issue			
Certificates of deposit	87.7	–	87.7
Medium-term notes	757.6	859.8	1,617.4
Covered bonds	1,422.2	365.2	1,787.4
Residential Mortgage Backed Securities	224.1	–	224.1
Total as at 31 December 2015	5,111.0	1,225.0	6,336.0
Total as at 31 December 2014	4,307.5	1,296.8	5,604.3

All of the euro denominated wholesale funding has been swapped back into sterling, except for £12.9 million which has been matched with euro denominated liquidity.

Risk Management Report **cont.**

An expected maturity analysis for wholesale funding is shown below. This is based upon the earlier of first call date or contractual maturity.

	2015 £m	2015 %	2014 £m	2014 %
Less than one year	2,268.2	35.9	1,803.2	32.2
One to two years	1,066.8	16.8	327.6	5.8
Two to five years	2,238.0	35.3	2,183.8	39.0
More than five years	763.0	12.0	1,289.7	23.0
Total	6,336.0	100.0	5,604.3	100.0

Maturity profile of financial assets and liabilities

The table below analyses the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining period to the contractual maturity date. In practice, customer deposits will be repaid later than on the earliest date on which repayment can be required. Likewise, in practice, customer assets may be repaid ahead of their contractual maturity. As such, the Society uses past performance of each asset and liability class along with management judgement to forecast likely cash flow requirements.

At 31 December 2015 (Audited)	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England[1]	2,587.8	–	–	–	–	2,587.8
Loans and advances to credit institutions	235.8	–	–	–	–	235.8
Debt securities	–	173.6	–	544.8	833.3	1,551.7
Loans and advances to customers	56.0	587.5	1,649.1	7,737.9	19,380.5	29,411.0
Derivative financial instruments	–	–	9.0	117.2	46.8	173.0
Other financial assets	–	0.4	9.7	37.2	34.1	81.4
Total financial assets	2,879.6	761.5	1,667.8	8,437.1	20,294.7	34,040.7
Liabilities						
Shares	22,306.2	–	1,501.9	1,547.7	–	25,355.8
Sale and repurchase agreements[2]	–	1,050.8	–	699.5	–	1,750.3
Deposits from banks – other	–	59.6	–	–	–	59.6
Other deposits	–	3.0	–	–	–	3.0
Amounts owed to other customers	–	622.3	180.2	4.0	–	806.5
Secured debt securities in issue – Residential Mortgage Backed Securities and covered bonds	–	0.7	24.7	1,397.7	588.4	2,011.5
Senior unsecured debt funding	–	67.8	35.4	1,203.5	398.4	1,705.1
Derivative financial instruments	–	1.3	11.9	157.0	183.3	353.5
Other financial liabilities	–	–	6.4	73.7	40.9	121.0
Subordinated liabilities	–	0.8	17.6	15.0	24.8	58.2
Subscribed capital	–	1.6	120.0	–	40.0	161.6
Total financial liabilities	22,306.2	1,807.9	1,898.1	5,098.1	1,275.8	32,386.1
Net liquidity gap	(19,426.6)	(1,046.4)	(230.3)	3,339.0	19,018.9	1,654.6

1. Includes £45.3 million mandatory reserve with the Bank of England.
2. Included in Deposits from banks on the Statement of Financial Position.

At 31 December 2014 (Audited)	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England[1]	2,114.5	–	–	–	–	2,114.5
Loans and advances to credit institutions	180.5	–	–	–	–	180.5
Debt securities	–	127.2	20.1	405.3	1,102.6	1,655.2
Loans and advances to customers	42.0	545.9	1,532.9	7,196.7	17,642.1	26,959.6
Derivative financial instruments	–	–	2.6	151.3	54.4	208.3
Other financial assets	–	0.3	1.4	61.4	35.0	98.1
Total financial assets	2,337.0	673.4	1,557.0	7,814.7	18,834.1	31,216.2
Liabilities						
Shares	19,693.9	–	1,410.7	2,291.0	–	23,395.6
Sale and repurchase agreements[2]	–	710.5	–	698.2	–	1,408.7
Deposits from banks – other	3.0	67.3	–	–	–	70.3
Other deposits	–	5.5	2.0	–	–	7.5
Amounts owed to other customers	17.4	390.3	44.6	–	–	452.3
Secured debt securities in issue – Residential Mortgage Backed Securities and covered bonds	–	502.2	24.7	748.5	699.5	1,974.9
Senior unsecured debt funding	–	6.0	29.7	750.8	904.1	1,690.6
Derivative financial instruments	–	0.5	1.7	99.0	222.1	323.3
Other financial liabilities	–	–	1.7	111.6	48.7	162.0
Subordinated liabilities	–	0.8	0.6	32.0	24.8	58.2
Subscribed capital	–	1.6	0.1	119.9	40.0	161.6
Total financial liabilities	19,714.3	1,684.7	1,515.8	4,851.0	1,939.2	29,705.0
Net liquidity gap	(17,377.3)	(1,011.3)	41.2	2,963.7	16,894.9	1,511.2

1. Includes £41.2 million mandatory reserve with the Bank of England.
2. Included in Deposits from bank on the Statement of Financial Position.

The following is an analysis of gross contractual cash flows payable under financial liabilities:

At 31 December 2015 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	22,263.8	1,550.6	1,595.9	–	25,410.3
Deposits, amounts owed to other customers and debt securities in issue	1,819.8	513.2	3,761.0	1,334.7	7,428.7
Other liabilities and adjustments	79.3	52.4	65.3	376.8	573.8
Subordinated liabilities	0.9	20.3	23.0	33.6	77.8
Subscribed capital	2.4	126.1	19.4	40.0	187.9
Total liabilities	24,166.2	2,262.6	5,464.6	1,785.1	33,678.5
Undrawn loan facilities	74.7	–	–	–	74.7
Leasing commitments	0.9	2.3	10.0	7.4	20.6

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At 31 December 2014 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	19,677.5	1,466.6	2,354.9	–	23,499.0
Deposits, amounts owed to other customers and debt securities	1,745.7	250.8	2,815.2	1,615.1	6,426.8
Other liabilities and adjustments	110.1	100.6	259.3	107.1	577.1
Subordinated liabilities	0.9	3.3	42.5	35.3	82.0
Subscribed capital	2.4	9.7	143.1	40.0	195.2
Total liabilities	21,536.6	1,831.0	5,615.0	1,797.5	30,780.1
Undrawn loan facilities	86.7	–	–	–	86.7
Leasing commitments	0.8	2.0	7.7	5.7	16.2

These results do not directly align to those presented for the balance sheet as they include interest relating to future periods. In addition, the tables above exclude cash flows beyond five years (other than the repayment of principal) that relate to subscribed capital.

Asset encumbrance

Society assets can be used to support collateral requirements for secured funding, central bank operations or third party repo transactions. Encumbrance benefits the Society as it provides cheaper and more stable funding. However, depositor members and other senior unsecured creditors are unable to benefit from the liquidation of encumbered assets in the event of insolvency, and risk bearing losses from a forced sale. Encumbrance is therefore reported and the associated risks are managed. An analysis of how the Society has used its balance sheet in this regard at 31 December 2015 is set out in the table below:

	Encumbered		Unencumbered		
	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total 2015 £m
Cash and balances with the Bank of England	–	227.7	2,360.1	–	2,587.8
Loans and advances to credit institutions	235.8	–	–	–	235.8
Debt securities	850.1	74.0	627.6	–	1,551.7
Loans and advances to customers	6,175.9	–	3,622.0	19,613.1	29,411.0
Derivative financial instruments	–	–	–	173.0	173.0
Hedge accounting adjustments	–	–	–	81.4	81.4
Non-financial assets	–	–	–	73.7	73.7
Total	7,261.8	301.7	6,609.7	19,941.2	34,114.4
FLS Treasury bills	903.3	–	1,142.2	–	2,045.5
Total as at 31 December 2015	8,165.1	301.7	7,751.9	19,941.2	36,159.9
Total as at 31 December 2014	6,741.0	290.3	7,809.9	17,759.7	32,600.9

1. Assets that have been utilised to support interest rate swap collateralisation agreements, third party secured funding operations, central bank operations or third party repo transactions and cannot be used for any other purpose.
2. Other encumbered assets are assets that cannot be utilised for secured funding due to legal or other reasons. This includes cash and assets supporting secured funding vehicles.
3. These assets are readily available as collateral to secure funding. Loans and advances to customers in this category comprise those that although technically encumbered are held in respect of retained self-issued notes in the Society's covered bond and securitisation programmes and Bank of England approved mortgage portfolios. The total of unencumbered available collateral is therefore referable to the total of on-balance sheet liquid resources in the table on page 42, the difference being £33.9 million of additional collateral.
4. Unencumbered other assets are therefore conservatively defined as not readily available for use as collateral. The loans and advances in this category include £12.7 billion which would be eligible for use to support future external or self-issuance under the Society's covered bond and securitisation programmes. A proportion of the remaining balance would also be suitable for such purpose subject to amending the programme structures.

External credit ratings

The perceived strength of the Society is a key mitigant to funding risk. The Society's long-term (from A3 to A2) and short-term credit ratings (from P2 to P1) were upgraded by Moody's in October 2015. Short and long-term credit ratings as at 25 February 2016 are set out below:

	Long-term	Short-term	Subordinated	Outlook	Date of last credit opinion
Moody's	A2	P-1	Baa1	Positive	October 2015
Fitch	A	F1	N/A	Stable	January 2015

Management of liquidity and funding risk

The function of the Society's business is 'maturity transformation', whereby the Society borrows for relatively short terms and lends on mortgages for much longer periods. This mismatch generates liquidity risk, the risk that the Society has insufficient funds to meet its obligations as and when they fall due. This could manifest itself in an inability to raise new wholesale funding and replace existing funding as it matures, due to a severe liquidity crisis in the money markets, or in a loss of member confidence that causes a 'run' on retail funds. The Society maintains at all times liquidity resources which are adequate, both as to amount and quality, to ensure that the Society's liquidity risk is managed to an acceptable residual level.

Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk. Funding risk is managed by ensuring that reliance on any single funding provider is minimised. This is principally achieved by limiting wholesale funding to a level lower than that imposed by the Building Societies Act and that agreed with the PRA. Diversifying the source of retail deposits is achieved by having a broad customer base spread throughout the UK. The Society is predominantly funded through retail deposits reflecting its long-term strategy. Wholesale funding is used to provide diversification and lower the overall cost of funding. Funding is managed centrally, enabling it to be used to fund assets throughout the Group.

Determining the appropriate mix and amount of liquidity to hold is a key decision for the Board, which recognises that the Society must remain a safe and attractive home for members' retail deposits. However, the more assets that are held in liquid form, the less that are available for the Society to lend to borrowing members. This conflicts with one of the core objectives of the Society, which is to provide finance to help people purchase residential properties. The more liquidity that is held, the lower the profitability of the Society and the less capital it generates. If capital is reduced then the capacity for new mortgage lending is restricted. Therefore, it is in the best interests of the Society's members as a whole for the Society to hold sufficient but not excessive levels of liquidity.

The Society's appetite for liquidity risk is set out in the Liquidity Risk Tolerance Statement which is approved annually by the Board. The tolerance statement is kept under regular review and revised in line with changes to the risk environment and regulatory context. The tolerance statement was last reviewed by the Board in December 2015 (as part of the Internal Liquidity Adequacy Assessment Process (ILAAP)) and is set with reference to the ability to meet all cash requirements throughout a prolonged combination stress as detailed later in this section. The tolerance statement is also set against the regulatory requirements, driven by the LCR.

Liquidity adequacy

The Board determines the level of liquid resources required to support the Society's business objectives through the annual undertaking of the ILAAP as part of the development of the Strategic Plan. In this process the Society reviews its liquidity risk management framework, together with the financial projections developed for the Strategic Plan, in order to assess the significant risks to which it is exposed and the adequacy of its liquid resources. The ILAAP is driven by the Society's risk tolerance and compliance with the ILAA Rules, including the need to meet the Overall Liquidity Adequacy Rule (OLAR).

The ILAAP considers a range of time horizons, in particular intra-day, one day, two weeks, three months and five years. The ILAAP is compliant with PRA Policy Statement 11/15 (CRD IV Liquidity), which has replaced Chapter 12 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms. The OLAR combination stress assessed in the ILAAP estimates the impact from a two week Society-specific stress combined with a three month market-wide stress.

Risk Management Report **cont.**

The ILAAP also assesses the adequacy of the liquidity policies that are included in the Treasury and Prudential Policy Statement. These policies set out various minimum criteria for the amount and quality of liquidity that must be held at all times and the programme for testing the periodic realisation of the various liquidity types. In addition, the Policy Statement incorporates various triggers and target operating levels that guide appropriate management actions.

Liquidity is held for each of the principal drivers of liquidity risk with the main risk to the Society being large unexpected withdrawal of retail deposits.

With regard to the OLAR combination stress, which considers a Society-specific stress for a period of two weeks at the same time as a prolonged market-wide stress for a period of three months, the following key assumptions are made:

- The Society's credit ratings are downgraded by two long-term notches.
- Long-term wholesale funding matures on its earliest call date and no additional issuance occurs.
- Severe retail outflows occur having regard to the mix of deposits, in particular those that are considered to be most sensitive to a stress event.
- Mortgage applications that have been received by the date of the stress are honoured through to completion at the normal completion rate.

The ILAAP is reviewed by the PRA through its Liquidity Supervisory Review and Evaluation Process (L-SREP), an in-depth periodic review and assessment of a firm's quantitative and qualitative liquidity risk management processes and operations. Following the L-SREP, the PRA provides Individual Liquidity Guidance (ILG), which sets out the amount and composition of eligible liquidity that the PRA requires the Society to hold. The ILG is set by reference to the LCR. As well as applying a transitional LCR from October 2015, the ILAAP is structured in accordance with the PRA Supervisory Statement, SS 24/15. The Delegated Act issued by the European Commission permits the PRA to tailor its requirements to individual firms, including the liquidity requirement and its composition. The PRA determines:

- A quantitative ILG comprising LCR Pillar 1 and Pillar 2 add-ons reflecting liquidity risks that are not captured by the LCR.
- A qualitative ILG, which will include actions required to mitigate risks, if any, outside of the PRA's risk appetite.
- The firm's overall liquidity risk profile.

The amount and type of liquidity held by the Society has not changed substantially as a result of the 2015 regulatory developments and continues to reflect a focus on UK Government securities and cash invested with the Bank of England in a reserve account. Whilst these assets realise a relatively low yield, this reflects the very low credit risk represented by a highly rated sovereign entity, such as the UK Government, and ensures that assets can be readily converted into cash to meet liabilities as they fall due.

Day-to-day management of the Society's liquidity position is the responsibility of the Liquidity Planning department working closely with the Treasury Front Office and overseen by the Society's Prudential Risk & Compliance function. Adequacy is assessed against a variety of limits and measures to ensure compliance with Board approved policy. The frequency of the assessment varies from daily to monthly dependent on the measure. Liquidity positions and the results of the combination stress, LCR and ILG are monitored regularly by ALCO and, through this Committee, by ERC, BRC and the Board. All measures were in surplus as at the year end and throughout the year.

As part of the Recovery and Resolution Plan, there are a number of contingent funding options designed to deal with liquidity or funding stress, which are evaluated on a regular basis through the Society's periodic realisation programme.

Outlook

The availability of funding through central bank schemes (such as the FLS) has led to a sustained benign funding environment for solvent UK banks and building societies. Whilst the Bank of England's Sterling Monetary Framework remains in place, the phased withdrawal of the FLS scheme will remove a significant source of low cost liquidity, increasing competition in wholesale and retail markets.

The Society has a strong track record of being able to attract retail funds before and since the financial crisis began, and with a competitive offering is well placed to withstand any deterioration in markets. The 'A' credit ratings held by the Society support access to wholesale markets giving further availability to funding sources. The Society continues to monitor regulatory changes in relation to bail-in requirements and Minimum Requirements for Own Funds and Eligible Liabilities (MREL) which could have an impact on pricing within the wholesale markets. The Society's credit ratings of A/F1 from Fitch and A2/P-1 from Moody's remain strong relative to other banks and building societies, supported by the quality of the loan portfolio, diversified funding, low cost base and resilient earnings.

Conduct risk

Overview

The Board defines conduct risk as the risk that the Society's behaviours fail to deliver good customer outcomes.

Conduct risk within financial services refers to the way in which firms treat their customers, their behaviour towards each other and the way they operate in the market. In recent years, issues associated with non-compliant processes and failure to meet the legitimate expectations of customers have proven to be a significant source of redress costs for the industry. In addition to direct fines from regulatory actions and costs of remediation, the industry has accrued considerable reputational damage. Conduct risk and culture are therefore a particular focus of the Financial Conduct Authority (FCA).

The Society's mutual ethos, further reinforced through its 'Putting Members First' philosophy, means it is well placed to meet its conduct risk responsibilities and ensure the fair treatment of members. 'Putting Members First' provides a clear understanding and expression of the Society's purpose which informs strategy, day-to-day decision making, the products offered and operations across the Society. The Society's focus on simple and transparent savings and mortgage products and not providing investment advice also mitigates against conduct risk and reduces the risk from third party provision of services to members.

Management of conduct risk

Recognising the increasing importance of conduct risk, the Board determined that conduct risk should cease to be overseen by the Operational Risk Committee and, in 2014, the Conduct Risk and Compliance Committee (CRCC) was established and is dedicated to the oversight of this risk. The activities of CRCC are ultimately overseen by the Board via the Committee hierarchy set out on page 26. During 2015, the Society developed its Conduct Risk Framework through which it has identified the potential conduct risks arising from its products, services and the documentation it provides to its members, and the control measures to manage, mitigate and monitor such risks. Representing a key element of the Society's ERMF, the Conduct Risk Framework provides a robust governance structure to reinforce the Society's inherent low risk appetite in this area.

During 2015, across the financial services industry the proportion of customer complaints upheld by the Financial Ombudsman Service has been over 50%[1]. By contrast, the Society has a very low uphold rate of 7%. Since 2009, when the Financial Ombudsman Service started to publish industry tables, it has asked for the outcome of referred Coventry Building Society customer complaints to be changed on just 61 occasions.

In contrast to the experience of many high street banks, Payment Protection Insurance (PPI) is not a material issue for the Society. Out of total PPI provisions of £27 billion for the industry as a whole, the Society has set aside only £3.9 million in total, including a provision of £1.7 million raised during the year. This is a consequence of the design of the PPI product sold and the member-focused approach in distributing the product provided by the Society.

Sales incentive schemes have frequently been cited as a major reason for customer detriment. By contrast none of the Society's employees has any sales-based targets or individual remuneration schemes.

Outlook

Given the long-term nature of many financial products, and cultural weaknesses in many organisations for a long period, it is anticipated that redress payments and fines will continue to be a key feature of the financial services sector for many years to come. In parallel, the FCA will continue to develop the regulatory regime around culture and conduct risk.

The Society will continue to 'Put Members First', placing customer outcomes at the heart of its decision making.

1. Source: Financial Ombudsman Service – latest published data, as at 25 February 2016.

Risk Management Report cont.

Operational risk

Overview

Operational risk is the risk of a loss arising from inadequate or failed internal processes, people and systems or from external events.

The table below defines each of the Society's five principal operational risk categories:

Risk category	Brief definition
Legal and regulatory	Fines, censure, supervisory intervention or legal enforcement action due to failure to comply with applicable laws, regulations, codes of conduct or legal obligations.
IT systems	Failure in the development, delivery and maintenance of effective IT solutions for the Society.
Information security	Failure to ensure the security, confidentiality, availability and completeness of data and information.
Financial crime	Criminal conduct relating to money or to financial services or markets, including offences involving fraud or dishonesty (including bribery), handling the proceeds of crime and/or the financing of terrorism. This also includes the risk that the Society fails to prevent or detect such activities.
People	An inability to recruit, develop or retain the appropriate human resources. Also includes failure to ensure the health and safety of employees, customers or third parties in the workplace.

The Society also manages and monitors operational risks associated with property and physical security, third party suppliers, business processes, financial reporting, and change.

Management of operational risk

Operational risks are managed as an integral part of the Society's operations. Management has a responsibility to understand how operational risk impacts the area of the business for which it is responsible, and for putting in place controls or mitigating activities, which are overseen and challenged by the Operational Risk function acting as the second line of defence. Operational Risk Committee (ORC), chaired by the Society's Chief Operating Officer, continues to provide primary oversight of all operational risk categories.

In addition to any direct loss attributable to risks in these categories, the reputational impact of such an event may damage the business leading to secondary impacts.

The Society stress tests such risks in order to better understand and manage the impact of their occurrence and their quantification to support regulatory capital allocation. The impact of a loss of confidence caused by reputational risk is often material to these scenarios. For these more severe scenarios the Society has developed a Recovery and Resolution Plan that details options available to the Society and any obstacles to successful resolution.

Legal and regulatory

The Society is committed to meeting its legal and regulatory responsibilities and has departments dedicated to overseeing regulatory change and monitoring compliance.

The financial services industry is undergoing transformational reforms. The general objectives of regulatory bodies are to improve consumer protection and to promote more stable and transparent financial markets.

The Society's simple business model and 'Putting Members First' principles mitigate some of these risks and the Society's Compliance functions support first line management by ensuring appropriate policies are in place and by providing challenge where necessary. The functions are organised to recognise the different objectives of the Society's regulators. The Conduct Risk Oversight & Compliance function focuses on retail conduct, consumer and product regulation. The Prudential Risk & Compliance function focuses on prudential and wholesale conduct regulation. Both functions review government and regulatory proposals for reform, and engage with the regulators and the Society's trade associations on initiatives that impact the building society sector as a whole. The Compliance functions undertake extensive monitoring programmes to provide assurance of adherence to regulatory standards and conduct risk expectations, and also support business change projects that have a regulatory aspect.

Regulatory reforms concerning capital are considered to be a strategic risk and are discussed later in this report.

IT systems

The Society recognises the risks of not keeping pace with technology. During 2015, the Society has continued to enhance its governance over the development of IT systems and implemented more rigorous controls over changes to its systems and its reporting of systems availability.

Furthermore, and representing a key part of its internally driven change programme, the Society is investing significant resources in ensuring the speed, efficiency, reliability and robustness of its IT systems and controls and their ongoing monitoring. The undertaking of any change programme is not without risk, as new systems and processes are introduced and integrated with existing ones. There will therefore be a strong focus on change governance and programme management to minimise these risks.

Information security

The ambition and capability of criminals to access an organisation's systems and data is a growing risk. The Society takes information security very seriously and recognises the need to protect the organisation and its members from the threats arising from cyber-attacks, and, inadequate resilience and information management. To achieve this, steps have been taken to detect and prevent the unauthorised use of information and any unauthorised attempt to access the Society's systems. Where information needs to be shared with third parties, reviews are carried out to ensure that these organisations provide the same level of security as the Society.

The Society ensures its defence strategy is supported with appropriate threat intelligence and response controls, whilst the overall approach is reviewed against peers and similar organisations to ensure the Society operates an appropriate protection programme aligned with the Board's risk appetite.

Financial crime

Financial crime risk is managed within the Payments & Financial Crime department, which reports through to the Chief Operating Officer.

The department's core purpose is to protect the Society and its members (and particularly vulnerable members) from fraud whilst minimising the impact of fraud prevention and detection measures on members.

Financial Crime operates as a separate primary risk discipline with dedicated expertise to respond to the evolving and substantial threat to the security and the safe operation of financial institutions and their customers.

Given the rapidly growing developments in technology, cybercrime and social media, the Society pays close attention to the source, likelihood and impact of financial crime generally and the various ways in which this could manifest itself.

People

The Society manages its people risk by having rigorous recruitment and selection processes, providing an induction programme before new employees commence work, undertaking performance management and providing courses and other opportunities for employees to develop their skills and experience throughout their time with the Society.

The Society benchmarks its reward strategy against others in the financial services sector, and offers a range of support services under the Society's 'Wellbeing Programme and Policy'. More generally, procedures and policies are designed to establish what the Society expects from employees and what employees can expect from the Society, with the objective of attracting and retaining high performing individuals. The Society periodically undertakes a survey of employee satisfaction and engagement with the Society's values and responds positively to any issues identified.

An area of continued focus during 2015 was the development of the Society's succession plans to strengthen its resilience to employee movements.

It is the policy of the Society to ensure as far as is practicable the health, safety, security and welfare of all employees and others affected by its activities and services. The Society has a Committee dedicated to ensuring sufficient and appropriate attention to these matters attended by senior management.

Operational risk outlook

The pace of regulatory change is expected to continue for the foreseeable future with far reaching impacts. Examples include the new EU General Data Protection Regulations, the Mortgage Credit Directive, the Deposit Guarantee Schemes Directive, the Anti-Money Laundering Directive, the Payment Services Directive and the Payment Accounts Directive. Revisions driven by the FCA include the implementation of the Senior Managers and Certification Regimes and changes to the regulation of savings accounts. Additional initiatives may result from the introduction of the Payments System Regulator.

In light of continued risk events both within and beyond the financial services sector, it is expected that the PRA will continue to focus on two areas of operational risk: systems' resilience and cyber security.

The Society recognises that cyber threat remains a key industry concern and will continue to adopt additional controls where appropriate.

Risk Management Report cont.

Despite substantial investments by financial institutions in technological solutions to combat the more sophisticated financial crime threats, the Society continues to witness an increasing trend of deception crimes targeting the consumer directly. Consequently the Society continues to strengthen its control environment to protect those who are most vulnerable to financial abuse, and continues to work collaboratively with industry partners to further improve controls and enhance customer awareness.

Business risk

Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to external factors. For example the Society's distribution of mortgage products is primarily undertaken via third party intermediaries. Whilst there is no evidence that this channel will not continue to be a key feature of the UK mortgage market, the Society's business model would need to evolve should this prove to be the case.

The Society considers strategic risk, the risk to delivering the Strategic Plan, to be the principal business risk. Strategic risk includes reputational risk.

Strategic risk

Strategic risk focuses on large, long-term risks that could become a material threat to the Society in delivering its corporate strategy. The management of strategic risk is intrinsically linked to, and is supported by the provision of consolidated business performance and risk reporting data to the Board and senior risk committees whose remit encompasses all risk categories.

A number of the top and emerging risks have the potential to affect more than one risk category and crystallise strategic risk. In addition, regulatory changes have the potential to threaten the viability of the Society's low risk model through increased capital requirements from leverage ratio requirements, the review of Internal Ratings Based modelling approaches and proposed revisions to the Standardised approach and capital floors. The continued volume and complexity of prudential and regulatory changes also represent a strategic risk with associated considerable and increasing costs for implementation and continuing compliance.

In recent years, there have been a considerable number of material operational and other risk events impacting the reputation of the financial services industry. The mutual sector has not been immune to these. Although the Society has been less impacted than many organisations, it will continue to manage its reputational risk carefully and invest significant resources in enhancing the robustness of its systems and controls, governance, product set and ongoing monitoring.

Outlook

The Society is aware of increasing competition in its core savings and lending markets through the emergence of 'challenger banks' and from mainstream UK banks as they focus on service delivery and non-investment activities.

It is anticipated the Society will retain its low cost position compared with its peers and will continue to focus on efficiency and cost control. It is inevitable, however, that cost pressures within the business will continue to increase arising from the pace and complexity of regulatory change, required levels of investment in technology and organic growth.

Buy to let activity is projected to increase in line with the projected growth of the balance sheet, but any moves to further regulate the market could have an adverse impact on this strategy. Alternatively the strong performance of this market could result in greater competition potentially eroding the Society's market share.

Overall the Society will continue only to take on risks that it understands and can manage. It will continue to maintain its core mutual values, offering good quality products through a simple business model and providing strong support for local and national community and charity work.

Capital

Capital management

Capital is held to protect depositors, by ensuring that there will be sufficient assets to repay liabilities even in the face of unexpected losses. When assessing the adequacy of its capital, the Board considers the material inherent risks to which the Society is exposed and also the need for capital to be available to support the growth of the business. Post the financial crisis and CRD IV, the regulatory capital framework comprises:

- A risk weighted capital requirement.
- A stress testing process to assess capital required to provide resilience for future adverse scenarios.
- A leverage ratio set in proportion to exposures regardless of their relative risk, which guards against underestimation of risks in risk weighted models.

New macro-prudential capital buffers have been introduced as part of the risk weighting and leverage ratio regimes and are being phased in as binding requirements. These new buffers are designed to mitigate system-wide and cyclical risks to prevent the economy 'overheating'.

The risk weighted and leverage ratio regimes are discussed on page 53. The Society's stress testing process is outlined in the stress testing and planning section on page 27 of this Risk Management Report. Further information on capital management is also included in the Society's Pillar 3 Disclosures (thecoventry.co.uk/2015pillar3).

Risk weighted capital requirements

The Society has for some time been granted permission by the Financial Services Authority (a predecessor of the PRA) to use an Internal Ratings Based (IRB) approach to retail credit risk and capital management. This approach allows the Society to calculate capital requirements for prime owner-occupier and buy to let mortgage exposures using internally developed models that reflect the credit quality of the Society's mortgage book. This permission reflects the Society's detailed understanding of its customer base and credit risk profile, and during 2015 this was extended to include the £0.5 billion mortgage book acquired from the Bank of Ireland in 2012. For other exposures and risk areas the Society follows the Standardised approach which uses capital risk weighting percentages set by CRD IV.

CRD IV sets minimum capital requirements: a Common Equity Tier 1 (CET 1) ratio of 4.5%, a Tier 1 capital ratio of 6% and a total minimum capital ratio of 8%. These ratios must be calculated as percentages of risk exposure amounts, principally in relation to credit and operational risk, and are known as the Pillar 1 requirement.

The Pillar 2 capital requirement encompasses firms' internal capital assessment and the supervisory review of those assessments and is intended to ensure that firms have adequate capital to support all the relevant risks in their business. The Pillar 2 requirement is divided into capital held against risks not captured or not fully captured by Pillar 1 (Pillar 2A), and risks to which a firm may become exposed over a forward looking planning horizon (Pillar 2B). As with Pillar 1, the total Pillar 2A capital requirement should be met with at least 56% CET 1 capital, up to 44% Additional Tier 1 (AT 1) capital, and a maximum of 25% Tier 2 capital.

During 2015, the PRA published Policy Statement 'Assessing capital adequacy under Pillar 2' which set out revised guidance for completing the ICAAP and calculating capital add-ons under Pillar 2 from 1 January 2016. This Policy Statement also explains the interaction of the new PRA Buffer (replacing the former Pillar 2B capital planning buffer) with the new CRD IV buffers as these are phased in.

To promote the conservation of capital and the build-up of adequate buffers that can be drawn-down in periods of stress, CRD IV implements the use of supplementary common equity capital buffers from 1 January 2016. These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB).

The following diagram shows the constituent elements of the CRD IV capital requirement that could impact the Society, the phasing in of these and the quality of capital that can be used to meet the minimum requirement. Capital used to meet the firm-specific Pillar 1 and Pillar 2A capital requirements, which may include a firm-specific buffer, may not be used to meet the additional CRD IV supplementary buffers.

CRD IV risk adjusted capital requirements

PRA Buffer (Firm specific)	Applicable from 1 January 2016. Firm specific buffer assigned by the PRA if CCoB and SRB buffers are considered to be insufficient.
Capital Conservation Buffer (CCoB)	Phased in from 2016-2019. Used to absorb losses in periods of economic and financial stress. 0.625% from 1 January 2016, increasing to 2.5% by 1 January 2019.
Systemic Risk Buffer (SRB)	Full application from 1 January 2019 up to 3%. In a consultation paper published in January 2016, the FPC is proposing 0% SRB for institutions with total assets less than £175 billion so there is no impact for the Society subject to this consultation.
Macro-prudential Countercyclical Buffer (CCyB)	Applies now, but currently set at 0%. FPC uses core indicators, with other relevant economic and financial data to set the CCyB (from 0% to 2.5%).
Pillar 2A	Firm specific calculation for risks not fully captured under Pillar 1.
Pillar 1	Firm specific calculation based upon individual risks (IRB or Standardised) - minimum of 8%.

Key: light blue = 100% Common Equity Tier 1; dark blue = Minimum 56% Common Equity Tier 1, up to 44% Additional Tier 1 (incl. maximum 25% Tier 2)

Risk Management Report **cont.**

The CCyB is currently set at 0% and the Financial Policy Committee (FPC) has stated that it will give due warning before implementing it.

With regard to the SRB, in a consultation issued in January 2016, the FPC are proposing that the SRB should be set at 0% for banks and building societies with total assets below £175 billion. Providing this is the case, the SRB should have no impact on the Society.

The new PRA Buffer (replacing the former Pillar 2B capital planning buffer from 1 January 2016) will only be applied to the extent that the PRA considers the CRD IV buffers to be insufficient (see diagram on page 53). The PRA has stated that it believes that for most firms, most of the time, the CRD IV buffers are likely to be sufficient once fully phased in.

Leverage ratio

CRD IV introduces a non-risk based leverage ratio that is supplementary to the risk based capital requirements and was originally proposed as a 'backstop' measure. The calculation determines a ratio based on the relationship between Tier 1 capital and exposures to on- and off-balance sheet items. The leverage ratio does not distinguish between unsecured and secured loans nor recognise the ratio of loan to value of secured lending. A binding requirement is expected to be introduced at the EU level in 2018.

In the meantime, the PRA has implemented the FPC's direction to introduce a UK leverage ratio framework. This currently only applies to banks and building societies with retail deposits of £50 billion or more.

The UK leverage ratio framework is more complex than the regime envisaged by the Basel Committee and is intended to 'mirror' aspects of the risk weighted capital requirement.

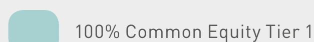
The components of the UK leverage ratio framework are a minimum ratio of 3%, of which a maximum of 25% may be met using high quality AT 1 capital, and two additional buffers that are to be met using CET 1 capital only: a Supplementary Leverage Ratio Buffer (SLRB), which will apply to the largest UK banks and building societies from 2019 (from 2016 for globally significant firms); and a Countercyclical Leverage Buffer (CCLB). The levels of these buffers will be set to 35% of the corresponding risk weighted SRB and CCyB (see previous section). The CCyB is set by the FPC and is currently 0% (maximum 0.9% leverage impact). The maximum SLRB would be 1.05% but subject to the FPC consultation mentioned previously is expected to be 0% for the Society.

The FPC has committed to reviewing the UK leverage ratio framework in 2017 after which review a binding ratio is expected to apply to the Society from 1 January 2018. The interaction between the EU and UK leverage ratio frameworks should then also become clearer.

The diagram on page 55 shows the constituent elements of the UK leverage ratio framework as it might apply to the Society, the phasing in of these requirements and the quality of capital that can be used to meet the minimum requirements.

UK leverage ratio framework

Supplementary Leverage Ratio Buffer (SLRB)	Full application from 1 January 2019 up to 1.05%. In a consultation paper published in January 2016, the FPC is proposing 0% SLRB for institutions with total assets less than £175 billion so there is no impact for the Society subject to this consultation.
Macro-prudential Countercyclical Leverage Buffer (CCLB)	Currently set at 0%. Set at 35% of the risk weighted CCyB (ranges from 0% to 0.9%).
Minimum Leverage	Applies from Jan 2018. Minimum leverage ratio set at 3% which the FPC judges to be consistent with domestic and international loss experience during historical banking crises.



The maximum theoretical leverage ratio requirement would be 3.9% (subject to the FPC consultation on the application of the SRB). The Board is confident that the Society will meet this requirement with an appropriate level of headroom and expects to maintain a ratio of at least 4%.

Regulatory capital analysis

There is a requirement to calculate and maintain regulatory capital ratios on both a Group consolidated (including all subsidiary entities) and Individual (or solo) consolidated basis, which includes only subsidiaries meeting particular criteria contained within CRD IV (for which the PRA has granted the Society a Capital Requirements Regulation Permission). However, for the Society there are no significant differences between the Group and Individual consolidated bases. Therefore the detailed capital disclosures in this report are on a Group consolidated basis only.

The following table shows CRD IV information on an end-point basis. This is based on all CRD IV requirements that were in force during the period with no transitional provisions permitted. The current transitional provisions allow Permanent Interest Bearing Shares (PIBS) and subordinated debt instruments to be eligible as capital under grandfathering provisions. Further information on CRD IV disclosures on a transitional basis is included in the Society's 2015 Pillar 3 Disclosures (thecoventry.co.uk/2015pillar3).

Risk Management Report cont.

Capital position	End-point 31 Dec 2015 £m	End-point 31 Dec 2014 £m
Common Equity Tier 1 (CET 1)		
General reserve	1,222.3	1,061.9
Available-for-sale reserve	2.5	(0.7)
Cash flow hedge reserve	29.8	32.8
Common Equity Tier 1 prior to regulatory adjustments	1,254.6	1,094.0
Common Equity Tier 1 regulatory adjustments		
Prudent additional valuation adjustment[1]	(1.6)	(1.7)
Intangible assets[2]	(16.3)	(15.9)
Cash flow hedge reserve[2]	(29.8)	(32.8)
Pension fund surplus adjustment[2]	(10.5)	(1.3)
Excess of expected loss over impairment[3]	(19.8)	(21.1)
Foreseeable distributions[4]	(9.4)	(10.0)
Common Equity Tier 1 capital	1,167.2	1,011.2
Additional Tier 1 capital (AT 1)		
Additional Tier 1 – Perpetual Capital Securities	396.9	396.9
Total Additional Tier 1 capital	396.9	396.9
Total Tier 1 capital	1,564.1	1,408.1
Tier 2		
Collective provisions for impairment	4.3	6.1
Total Tier 2 capital	4.3	6.1
Total capital	1,568.4	1,414.2
Risk weighted assets		
IRB approach		
Credit risk – retail exposures	3,093.9	3,020.4
Standardised approach		
Credit risk – retail exposures	199.4	361.6
Credit risk – liquidity book	102.5	112.8
Credit risk – other	54.9	39.4
Credit valuation adjustment risk	37.8	46.5
Operational risk	486.1	396.5
Total risk weighted assets	3,974.6	3,977.2
Common Equity Tier 1 ratio	29.4%	25.4%

1. A prudent valuation adjustment is applied in respect of assets and liabilities held at fair value.
2. Items do not form part of regulatory capital, net of associated deferred tax.
3. The expected loss over accounting provisions is deducted, gross of tax.
4. Foreseeable distributions in respect of AT 1 securities are deducted, net of tax.

The increase in CET 1 capital, Tier 1 capital and total capital is primarily caused by retained profit of £171.3 million.

Despite the growth in the mortgage book, risk weighted assets have marginally decreased as a result of house price inflation reducing effective risk weights and the risk weighting of an existing portfolio on an IRB rather than Standardised basis.

The Society completed a whole loan sale of its beneficial interest in £0.3 billion of non-member buy to let mortgages originated by its subsidiary Godiva Mortgages Limited (Godiva) to a third party in the final quarter of the year. These mortgages have been derecognised from the Group's Statement of Financial Position – see note 18 to the accounts. Similarly, as the Group does not retain any economic interest in the transferred mortgages and has not provided any financing to the third party entity, from a regulatory capital perspective the mortgages are not required to be risk weighted or included as an off-balance sheet exposure in the calculation of the leverage ratio.

The movements described above have resulted in an increase in the Society's CET 1 ratio from 25.4% % to 29.4%.

The Individual Consolidated CET 1 ratio on an end-point basis at 31 December 2015 was 0.6% higher than the Group ratio due to assets held by entities that sit outside of the Individual Consolidation.

At 31 December 2015, and throughout the year, the Society complied in full with the capital requirements that were in force.

The following table details the leverage ratio on an end-point basis. The calculation has been performed in accordance with the definition of CRD IV as amended by the European Commission's delegated act. The calculation reflects constraints on the inclusion of AT 1 capital under the FPC's UK leverage ratio framework. Whilst all of the Society's AT 1 capital meets the Basel III requirements and therefore serves to protect members' interests, only £266.5 million (2014: £242.5 million) is eligible for this measure.

Leverage ratio	End-point 31 Dec 2015 £m	End-point 31 Dec 2014 £m
Total Tier 1 capital	1,564.1	1,408.1
Adjustment for AT 1 restriction	(130.4)	(154.4)
Total Tier 1 capital for leverage ratio	1,433.7	1,253.7
Leverage ratio exposures		
Total balance sheet assets	34,114.4	31,278.3
Mortgage pipeline[1]	810.7	684.3
Other committed facilities (undrawn lending)[1]	29.5	33.8
Repurchase agreements[2]	638.5	392.2
Netted derivative adjustments[3]	(17.9)	(27.1)
Other adjustments[4]	(44.4)	(33.9)
Total leverage ratio exposures	35,530.8	32,327.6
Leverage ratio	4.0%	3.9%

1. Mortgage pipeline and other commitments are subject to a 50% risk weighting as per the delegated regulation amending CRD IV.
2. Repurchase agreements represent the extent to which collateral provided on repurchase agreements exceeds the amount borrowed.
3. The netted derivative adjustment figure converts the accounting value of derivatives to an exposure measure.
4. Other adjustments predominantly relate to asset balances that have already been included in the capital calculation and these are therefore removed from the total balance sheet assets figure.

Risk Management Report **cont.**

The increase in total Tier 1 capital is wholly attributable to the increase in CET 1 capital, primarily driven by retained profits in the year.

Although risk weighted assets have marginally decreased, total leverage ratio exposures have increased predominantly due to a £2.5 billion increase in the size of the mortgage book and a £0.4 billion increase in balance sheet liquidity.

These movements have resulted in an increase in the leverage ratio to 4.0 % (2014: 3.9%).

The required leverage ratio disclosures using the required European Banking Authority Templates published and subsequently adopted by the European Union in February 2016 are available in the Society's 2015 Pillar 3 Disclosures (thecoventry.co.uk/2015pillar3).

Outlook

Although the PRA has clarified its policy on a number of areas in 2015, significant elements of the final capital requirements (in addition to the leverage ratio framework discussed above) remain unclear.

The Bank of England is currently consulting on the minimum requirement for own funds and eligible liabilities (MREL) as part of the European Union Bank Recovery and Resolution Directive (BRRD). This sets out the minimum and form of liabilities which can be utilised by the Bank of England to absorb losses for resolution purposes. The Society is awaiting confirmation of its individual MREL requirement which will come into force on 1 January 2020. Final rules are expected in the first half of 2016.

The Society continues to monitor other regulatory developments that could lead to an increased level of capital requirement. These include the Basel Committee on Banking Supervision review of the Standardised approach for calculating credit risk capital requirements and the replacement for the Basel 1 floor. Further consultation papers, including a quantitative impact study, are expected during 2016.

These reforms could have a significant impact and challenge the ability of the Society to grow at the levels seen in recent years. Given the low risk nature of the balance sheet and the Society's strong performance in stressed conditions, the Board will seek to participate in the consultation process to ensure the final outcome is justified and applied proportionately. All the confirmed regulatory changes are reflected in the Society's capital management plans based on its understanding of the latest developments.

Long-term viability statement

In accordance with provision C.2.2 of the 2014 revision of the UK Corporate Governance Code, the directors have assessed the prospects of the Society over a longer period than the 12 months required by the 'going concern' provision (see the Directors' Report on page 90).

The directors' assessment is based on a robust review of the Society's principal risks, the Strategic Plan and the risk management framework (including risk appetite and risk culture) described within this Risk Management Report. This assessment is further supported by the ICAAP, ILAAP, reverse stress testing and Recovery and Resolution Plan.

The directors consider this to be a suitable process to enable them to form a reasonable expectation of the Society's prospects over a five year period. This period was chosen as the Society's Strategic Plan, ICAAP and ILAAP all cover a five year period.

The Strategic Plan projects the Society's ongoing profitability, capital and funding positions as satisfactory to the end of the five year plan period even in a range of adverse scenarios. Inherent uncertainty with regard to a number of factors, including geopolitical, economic and regulatory, inevitably increases over the planning period and the directors consider that, in the outer years, these factors become increasingly difficult to predict as described in 'Top and emerging risks' section on pages 28 to 29. However, the results of reverse stress testing also conclude that those scenarios that have the potential to break the Society were generally highly implausible.

In assessing long-term viability the directors have made the key assumption that the intermediary channel, upon which the Society has a strong reliance, continues to be a key feature of the UK mortgage market.

Subject to the uncertainty in the outer years noted above and based upon the assessment set out above, the directors therefore have a reasonable expectation that the Society will be able to continue in operation and meet its liabilities as they fall due over the period to December 2020.

Welcome to
Governance

In this section you will find details of how Coventry Building Society is managed in the interests of its members, the role and constitution of the Board and various committees that ensure the Society's operations are effectively supervised.

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For our full glossary please go to page **139**

What makes us different?
Case study

Listening to Members
The Society established a Members' Council in 2008, using it to provide a direct and regular link from the Board to the wider membership. The Council consists of up to 12 members who volunteer to work with the Society's management and Board to provide feedback, assess Society plans and new initiatives.

Every Members' Council meeting has at least one non-executive director in attendance, providing the Board with a valuable opportunity to listen to the views of members.

Board of Directors

The Board places the highest priority on effective corporate governance as part of its commitment to Putting Members First in everything the Society does.

Ian Pickering

Chairman

Ian Pickering joined the Board as a non-executive director in 2005 and was appointed Chairman of the Board on 1 January 2013. He is also Chairman of the Nominations and Governance Committee and a member of the Remuneration Committee, and the Non-Executive Directors' Remuneration Committee.

A graduate of Cambridge University, Ian is a qualified Chartered Accountant and for the past 10 years has held a number of non-executive directorships. He started his career as an auditor, working principally in financial services. He then spent 20 years in senior positions in the engineering industry, including at Dennis Group plc and Manganese Bronze Holdings plc.

Bridget Blow CBE

Deputy Chairman

Bridget Blow joined the Board as a non-executive director in 2007. Bridget was the Society's Deputy Chairman from 2009 until May 2012 and subsequently reappointed to this role on 1 January 2013. She is a member of the Board Audit Committee, the Remuneration Committee and the Nominations and Governance Committee.

Bridget is an experienced company director with a strong IT background, having been chief executive of ITNET plc. Bridget was a non-executive director of the Bank of England between 2000 and 2005 and chairman of Trustmarque Group until June 2013. She is a past president of the Birmingham Chamber of Commerce and Industry, is the chair of the CBSO and until recently was a non-executive director of the Birmingham Hippodrome.

Janet Ashdown

Non-executive Director

Janet Ashdown joined the Board as a non-executive director in September 2013. She is a member of the Remuneration Committee and the Board Risk Committee.

Janet worked for BP for 30 years until 2010, with experience in the UK and overseas. Her last role in BP was as head of BP's UK retail and commercial fuel marketing and supply business. She also spent over 10 years in BP's oil global trading business as a trader and trading manager. On leaving BP Janet became chief executive of Harvest Energy, a UK-based oil distribution and marketing business. She is currently a non-executive director of SIG plc, Marshalls plc (both members of the FTSE 250) and of the Nuclear Decommissioning Authority.

Peter Ayliffe

Non-executive Director

Peter Ayliffe joined the Board as a non-executive director in May 2013. He is a member of the Board Audit Committee and the Nominations and Governance Committee.

Peter was president and chief executive officer of Visa Europe from March 2006 to September 2013. Prior to joining Visa Europe, Peter spent over 30 years in retail banking and was for the last two of those years a main board director at Lloyds TSB with responsibility for the UK retail bank. He has also been a member of the board of Investors In People (UK), Visa International and Visa Europe and president of the Chartered Management Institute. Peter is currently chairman of Monitise plc and a trustee of the charity Pennies.

Roger Burnell

Senior Independent Director

Roger Burnell joined the Board as a non-executive director in 2008. Roger is the Society's Senior Independent Director, is Chairman of the Board Risk Committee and is also a member of the Board Audit Committee and the Nominations and Governance Committee.

Roger is a Chartered Accountant with over 35 years' senior executive and non-executive experience. He worked for several businesses within Thomson Travel Group before becoming group chief operating officer and has also been chairman of a number of businesses and senior independent director of Thomas Cook Group.

Ian Geden

Non-executive Director

Ian Geden joined the Board as a non-executive director in 2008. Ian is Chairman of the Remuneration Committee. He is also a member of the Board Risk Committee and the Nominations and Governance Committee.

Ian has over 30 years' experience in the financial services sector, primarily in the mutual sector, including NFU Mutual where he was chief executive before retiring at the end of 2008. Ian was also vice chairman of the Association of British Insurers (ABI) and chairman of the Association of Mutual Insurers. Ian is a non-executive director of Faraday Underwriting Limited and of Faraday Reinsurance Co. Limited.

Board of Directors **cont.**

Glyn Smith

Non-executive Director

Glyn Smith joined the Board as a non-executive director in 2010. Glyn is Chairman of the Board Audit Committee and the Models and Ratings Committee and is a member of the Board Risk Committee.

Glyn has over 35 years' experience in the financial services sector, most notably as a senior executive at Barclays Bank PLC and as finance director of Portman Building Society. He was previously a non-executive director at Stroud & Swindon Building Society.

A graduate of Cambridge University, Glyn is a Chartered Accountant, with over 10 years' experience as a non-executive director in both the public and private sectors. He is currently a non-executive director of Covent Garden Market Authority, FCO Services and the Reclaim Fund.

Mark Parsons

Chief Executive

Mark Parsons joined the Board as Chief Executive in July 2014. Mark is Chairman of the Non-Executive Directors' Remuneration Committee.

Mark was previously chief financial officer for retail and business banking at Barclays Bank PLC. Mark worked at Barclays Bank PLC for eight years, having joined as managing director of the home finance division of the UK retail bank. He later served as deputy chief executive of the UK retail bank.

Mark is a graduate of Sheffield University and a Chartered Global Management Accountant. His career spans 30 years in retail financial services, having worked at Abbey National and PwC prior to Barclays Bank PLC, in leadership roles covering finance, products, branches and personnel. He has previously served as deputy chairman of the Council of Mortgage Lenders.

John Lowe

Finance Director, Executive Director

John Lowe joined the Board as Finance Director in 2010. John is a member of the Non-Executive Directors' Remuneration Committee.

John joined the Society in 2007, initially to manage the Corporate Planning and Product Development functions, before assuming the role of Deputy Finance Director in 2009. A graduate of Oxford University, John is a Chartered Accountant and, since qualifying with Deloitte, has over 18 years' experience of financial services gained across a broad range of businesses.

Peter Frost

Chief Operating Officer, Executive Director

Peter Frost joined the Board in November 2012 as the Society's Chief Operating Officer and has responsibility for all aspects of the Society's operations, including IT and Change.

A graduate of Liverpool University, Peter has over 25 years' experience in financial services. Prior to joining the Society, Peter worked at Barclays Bank PLC where he was operations director for the UK retail bank. Before this he had a number of positions at Woolwich Building Society and Woolwich plc. Peter has also held a number of non-executive directorships including roles at Vaultex and iPSL.

Directors' Report on Corporate Governance

'Putting Members First'

The Board places the highest priority on effective corporate governance as part of its commitment to Putting Members First in everything the Society does. The Board is accountable to the Society's members for the operation of the Society and the Board encourages feedback on all aspects of the Society's activities.

This report explains how the Board applies the principles of the UK Corporate Governance Code 2014 (the Code) and the Building Societies Association Guidance for Building Societies on the Code. The Board has considered the requirements of the Code and will continue to comply in a manner which is proportionate to the Society's size and scale.

In 2015 the Society complied with the provisions of the Code with the exception of provisions relating to dialogue with major shareholders (which are not applicable due to the Society's mutual status). Nevertheless, the Society is committed to maintaining a dialogue with its members. This is further discussed on page 67.

This report also contains disclosures under Part Eight of the Capital Requirements Regulation (Pillar 3) relating to corporate governance.

The role of the Board

The Board of directors is responsible for the overall direction and management of all affairs and business of the Society and its subsidiaries. The Board has a general duty to ensure that the Society acts in accordance with its Rules, the binding document that sets out which activities the Society can undertake, as well as all applicable laws together with regulations and guidance issued by relevant regulatory authorities.

In particular it is responsible for:

- Setting the culture and values of the Society.
- Challenging and approving the long-term strategy of the Society and its subsidiary companies and reviewing the Strategic Plan and annual budget.
- Determining and reviewing the Society's risk appetite and the major risks faced by the Society.
- Assessing the adequacy of capital and liquidity.
- Monitoring the performance of the Society and holding the Chief Executive and the executive team to account on behalf of the members of the Society.
- Approving the Society's Remuneration Policy and the remuneration for directors and certain other members of senior management.
- Communications with stakeholders by approving the annual financial statements and oversight of engagement with members.

The Board of directors

The Society's Rules require that the Board comprises between six and 12 directors. The Board currently comprises a Chairman, six independent non-executive directors and three executive directors. The Board has determined that its current composition is appropriate.

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose. The Chairman is responsible for leading the Board and ensuring that it acts effectively. The Chief Executive has overall responsibility for managing the Society and for implementing the strategies and policies agreed by the Board.

The role of the Deputy Chairman is to provide support to the Chairman in his role of leading and managing the Board. The role of the Senior Independent Director is to ensure the views of members and other key stakeholders are conveyed and, in conjunction with the other directors, evaluate the performance of the Chairman and lead succession planning for the role of Chairman.

The following persons served as directors of the Society during the year: Janet Ashdown, Peter Ayliffe, Bridget Blow, Feike Brouwers, Roger Burnell, Peter Frost, Ian Geden, John Lowe, Mark Parsons, Ian Pickering and Glyn Smith.

Feike Brouwers retired as a director on 31 March 2015. Bridget Blow will retire from the Board at the end of the 2016 Annual General Meeting (AGM) and will not stand for re-election. Roger Burnell replaced Bridget Blow as Senior Independent Director on 1 January 2016. It is envisaged that Bridget will continue as Deputy Chairman until her retirement following which the Board will elect the next Deputy Chairman at its first meeting after the AGM.

In the opinion of the Board, Janet Ashdown, Peter Ayliffe, Bridget Blow, Roger Burnell, Ian Geden and Glyn Smith are independent in character and judgement based on guidance in the Code. The Board considered Ian Pickering was independent at the time of his appointment as Chairman on 1 January 2013.

Non-executive directors are independent of the Society's management and are not required to devote the whole of their time to its affairs.

Letters of appointment for the non-executive directors are available from the General Counsel and Secretary on request.

Directors' Report on Corporate Governance **cont.**

The directors' biographies are included on pages 60 to 62. Further information about the directors, including a full list of other directorships, can be found in the Annual Business Statement on page 138.

How the Board fulfils its role

The Board applies the principles of good governance in the following way:

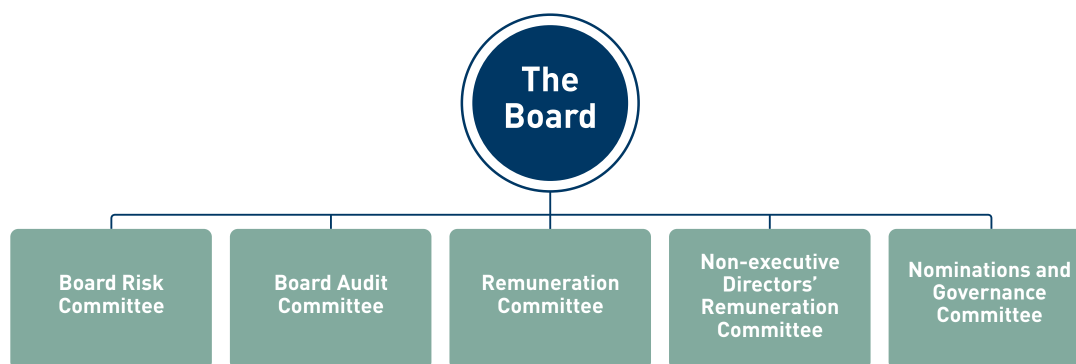
- The Board meets regularly and holds two strategy review days each year outside the formal meeting cycle, which gives all directors an opportunity to develop and challenge proposals on strategy.
- The non-executive directors meet, without executive directors present, at least once a year as required by the Code but in practice meet more frequently.
- The Chairman sets the tone of the Board meetings to ensure, amongst other things, that there is a culture of openness and constructive challenge from both non-executive and executive directors. This is assessed through the annual Board effectiveness review process.
- The Board has a formal schedule of matters that are reserved to it.
- Directors receive accurate, timely and clear information and it is the responsibility of the Chairman to ensure that this information is considered by the Board.
- The size, composition and diversity of the Board and the executive team are kept under review to ensure that there is adequate succession planning for executive and non-executive directors and that the Board has the appropriate skills and experience for the direction of the Society's activities. See pages 65 to 66 relating to the Nominations and Governance Committee for further details.
- All directors have access to the advice and services of the General Counsel and Secretary, whose appointment is a matter for the Board. The General Counsel and Secretary is responsible for ensuring compliance with Board procedures and advising the Board, through the Chairman, on governance related matters.
- All directors have access to independent professional advice at the Society's expense, if needed, in order to fulfil their responsibilities as directors.

The main matters reserved to the Board are the matters mentioned under The role of the Board on page 63. Other matters reserved to the Board include key appointments, approval of major projects and other major expenditure, the Society's main policies and delegation of matters to the Chief Executive and the other executive directors.

The Society maintains liability insurance cover for directors and officers as permitted by the Building Societies Act 1986.

Board Committees

The Board has established a number of Committees, as shown below:



Summaries of each Committee's remit and activities during the year are set out on the following pages. The terms of reference of each Committee are available on the Society's website (thecoventry.co.uk/corporategovernance) and from the General Counsel and Secretary on request. During the year the terms of reference of each Committee were reviewed and updated when appropriate to ensure effectiveness of decision making and oversight and alignment to the Society's Enterprise Risk Management Framework (ERMF) and the Senior Managers Regime (SMR).

Board Risk Committee

The Board Risk Committee met nine times during the year. Members of the Committee are:

Roger Burnell (Chairman of the Committee)
Janet Ashdown
Ian Geden
Glyn Smith

The Board Risk Committee is the senior risk committee in the Society. It has delegated authority from the Board and assists the Board in fulfilling its responsibilities for risk management across the Society. The Committee's remit includes the following:

- Review and approve the Society's risk strategy, culture and principles, challenging as appropriate to ensure a risk culture that Puts Members First in the Society.
- Satisfy itself on the design and completeness of the Society's internal control and assurance framework, including the ERMF.
- Review key risk policies and frameworks including principal risk appetite statements.
- Assure itself and the Board that current and potential risk exposures are being managed appropriately.
- Oversight of the Risk and Compliance functions, including their performance and independence.

The Committee Chairman reports to the Board after each meeting of the Committee.

In 2015, the Committee considered reports relating to principal risks and uncertainties faced by the Society, which are set out in the Risk Management Report (pages 22 to 58). At each meeting it considered a detailed consolidated risk report.

Other matters considered by the Committee during the year included:

- Review of the Society's ERMF and recommending it for approval by the Board.
- Assessment of which risks constitute principal risks.
- Review of key policies linked to the Society's principal risks, including the Society's lending and treasury policies.
- Review of the Society's overall risk appetite and the risk appetites for each of the principal risks faced by the Society, including risk limits and tolerances.
- Review and monitoring of second line assurance over risk management across the Society.
- Review of the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP).
- Stress testing of scenarios (including reverse and alternative stress testing) and the ICAAP and ILAAP.

Board Audit Committee

Details of the Board Audit Committee are contained in the Board Audit Committee Report on pages 69 to 73.

Remuneration Committee

Details of the Remuneration Committee are contained in the Directors' Remuneration Report on page 86.

Non-executive Directors' Remuneration Committee

Details of the Non-executive Directors' Remuneration Committee are contained in the Directors' Remuneration Report on pages 86.

Nominations and Governance Committee

The members of the Committee are:

Ian Pickering (Chairman of the Committee)
Peter Ayliffe
Bridget Blow
Roger Burnell (from 1 January 2016)
Ian Geden

The Committee is responsible for reviewing and making recommendations to the Board on matters relating to the structure, size and composition of the Board (including Board succession planning, the appointment of new directors and the appointment of non-executive and executive directors to Committees of the Board) and certain aspects of senior management appointments. The recruitment policy relating to the Board is that when vacancies on the Board are being filled, the Committee considers the skills, knowledge, experience and diversity (including gender) of existing members of the Board in order to consider the capabilities needed on each occasion.

Directors' Report on Corporate Governance **cont.**

The Committee also takes an active role in other matters relating to the governance of the Society, such as reviewing the effectiveness of the Board and its Committees, reviewing the matters reserved to the Board, Board training and considering conflicts of interests.

As part of its terms of reference, the Committee reviews diversity on the Board. It also recommends to the Board a target for female representation on the Board and a policy as to how to reach that target in accordance with Article 88 of the Capital Requirements Directive. The Society's Board has set a target of 25% female directors by December 2017. The current percentage is 20%.

The Nominations and Governance Committee considers that the directors currently comply with Article 91 of the Capital Requirements Directive, since all directors are able to commit sufficient time to perform their duties at the Society and none of the directors has more than the maximum number of directorships when taking into account the provisions relating to group directorships and non-commercial organisations.

The Committee met five times during the year. Among its activities in 2015 were:

- Overseeing the Board governance changes necessary to implement the SMR, including changes to terms of appointment, a revised policy framework and revised Board Committee terms of reference.
- Reviewing the Society's succession plan with particular reference to ensuring an appropriate supply and turnover of independent non-executive directors.
- Overseeing the recruitment of an additional non-executive director. Norman Broadbent, a specialist search firm were engaged to assist the Society in identifying and recruiting a candidate for this role. The Society anticipates making an appointment in 2016. Norman Broadbent has no other connection with the Society.
- Reviewing the matters reserved to the Board and the Board annual planner to ensure that matters were being considered or delegated appropriately.
- Reviewing directors' proposed external appointments to ensure they did not represent a conflict of interest or exceed the number of directorships permitted by the Capital Requirements Directive.
- Reviewing the respective roles of the Chairman and Chief Executive.
- Overseeing actions to improve the effectiveness of the Board and its Committees, including coordinating the 2015 external effectiveness review and agreed follow-up actions.

Appointments to the Board

Bridget Blow will retire from the Board at the end of the 2016 AGM. The Board has considered the provisions of the Code relating to re-election of directors, and has decided that it is in the best interests of members to submit the entire Board for annual re-election by the members. Accordingly all directors who were on the Board at the end of the 2015 AGM with the exception of Bridget Blow have voluntarily submitted themselves for re-election and the Board has unanimously decided to recommend them for re-election by the members at this year's AGM.

Ongoing Board development

New directors complete a tailored induction programme that covers all key aspects of the Society's business and regulatory environment, including meetings with senior management and branch visits. Established directors update their skills, knowledge and familiarity with the Society through a programme of branch and department visits and presentations by senior managers. During the year, the whole Board received training on changes to regulations, capital planning and the SMR, in addition to a number of topics specific to the Society's business. The Board's ongoing training and development needs are reviewed by the Nominations and Governance Committee and underpinned by a dedicated Board training policy.

Board and Board Committee attendance 2015

Name	Title	Number of Board meetings 11	Number of Board Audit Committee meetings 6	Number of Board Risk Committee meetings 9	Number of Remuneration Committee meetings 7	Number of Non-executive Directors' Remuneration Committee meetings 4	Number of Nominations and Governance Committee meetings 5
Ian Pickering	Chairman	11			7	4	5
Bridget Blow	Deputy Chairman	11	6		7		5
Janet Ashdown	Non-executive Director	10		8	7		
Peter Ayliffe	Non-executive Director	11	6				5
Feike Brouwers[1]	Chief Risk Officer	3					
Roger Burnell	Non-executive Director	11	6	9			
Peter Frost	Chief Operating Officer	11					
Ian Geden	Non-executive Director	10		9	6		5
John Lowe	Finance Director	11				4	
Mark Parsons	Chief Executive	11				4	
Glyn Smith	Non-executive Director	11	6	8			

1. Retired from the Board in March 2015. Maximum number of Board meetings was 3.

Review of Board effectiveness

The Board periodically reviews its own performance and that of its Committees. In 2015, the Board commissioned an external review of its own effectiveness. The review was carried out by SCT Consultants who reviewed a wide variety of Board documents including those relating to governance and interviewed Board members before observing a meeting of the Board. The review concluded that the Society's Board was rigorous, hard-working, diligent and had a strong sense of its responsibilities for safeguarding the mutual ethos of the Society. Areas in which further improvement could be made included people and talent strategy and progression and greater Board oversight and review of major investment decisions. SCT Consultants had assisted the Board in 2014 in connection with governance related matters.

In addition to the external review, the Board reviewed its own performance and that of its Committees later in 2015. Each Board Committee reviewed its own effectiveness by means of a self-assessment questionnaire and by undertaking an assessment of compliance with its terms of reference. Each Committee Chairman reported the outcome of this review to the Board.

The performance of the directors was appraised by the Chairman. The Chairman's performance review was led by the Senior Independent Director during 2015 taking into account the views of the rest of the Board.

The Board concluded that all were operating effectively, with the Nominations and Governance Committee taking the lead on implementing further improvements to the effectiveness of the Board and its Committees.

In addition, all directors have open and direct access to the Chairman and to the Senior Independent Director in order to raise any issues of concern.

Relations with members

A key aspect of the role of the Board is to ensure that the views of the Society's members are appropriately reflected in decision making. Members' views are communicated in a variety of ways. During 2015, a revised policy of non-executive director attendance at each quarterly Members' Council was implemented. In September 2015, a number of members of the Board, both executive and non-executive directors, attended a members' roadshow in Stratford-upon-Avon. In addition, the Board received updates on the work of the Society's dedicated customer experience team and the measures taken to elicit the views of customers and prioritise the most important customer experience improvements, including the results of an in-depth survey of 900 customers conducted by an external consultancy.

Non-executive directors also engage with the Society's members through attending the AGM. The Chairmen of all Board Committees are available to answer questions at the AGM.

Directors' Report on Corporate Governance **cont.**

All members who are eligible are encouraged to exercise their vote at the AGM by one of the following means; attending in person, sending a proxy to the meeting, voting by post, voting online, or in any branch. All means of voting other than in person at the meeting count as voting by proxy. All resolutions are taken on a poll to enable proxy votes to be counted and the Chairman indicates the level of proxies lodged on each resolution by announcing the numbers for and against the resolution and the number withheld. The proxy voting form explains the status of votes withheld. A separate resolution is proposed on each item, including a resolution to receive the Annual Report & Accounts. The Society employs Electoral Reform Services Limited to act as independent scrutineers and ensure the votes are properly received and recorded.

Diversity

In order to foster diversity within the Society and particularly within leadership roles, the Society has a number of development programmes in place for employees, including a mentoring programme to support senior managers as they develop towards executive roles, and a focus on internal mobility which serves to highlight opportunities and encourages employees to realise their potential. An equality, diversity and inclusion steering group has been formed, from which various initiatives have emerged and strong employee involvement has been seen. In addition, when working with recruitment providers to recruit executive and non-executive directors, providers are appointed who are experienced and successful in the identification of shortlists of candidates with diverse backgrounds.

Internal controls and risk management

The principal risk categories and how these are mitigated are described in greater detail in the Risk Management Report (see pages 22 to 58).

The Board is responsible for the system of internal control, which is designed to facilitate effective and efficient operations whilst managing the risk of failure to achieve business objectives. The Board and senior management are committed to maintaining a robust control framework and for reviewing its effectiveness.

The Board reviews the effectiveness of systems of internal control and risk management through a combination of processes including:

- Regular reports to the Board, through the Board Risk Committee, from the Risk function on the principal risks facing the Society and the strength of the controls in place to mitigate such risks. The Chief Risk Officer has direct access to the Board Risk Committee Chairman.
- Regular reports to the Board, through the Board Audit Committee, from the Internal Audit function in respect of its independent audits of risk management processes and the effectiveness of internal controls across the Society (further information can be found in the Board Audit Committee Report on page 71). The Chief Internal Auditor reports directly to the Board Audit Committee Chairman.
- An annual review of the effectiveness of the ERMF by the Chief Risk Officer, which is considered by the Board Risk Committee. This is subject to a third line review by the Internal Audit function, which is in turn considered by the Board Audit Committee.
- A consolidated risk report presented by the Chief Risk Officer at each Board meeting on key current and emerging risks and the efficacy of the controls and other mitigating actions in place to manage the risks.

The Board is able to confirm that a robust assessment of the principal risks facing the Society has been carried out, including those that would threaten its business model, future performance, solvency or liquidity.

The Board has carried out a review and is satisfied that during 2015 the Society maintained adequate risk management arrangements taking into account its profile and strategy together with an adequate system of internal control, taking into account the requirements of the Code.

Board Audit Committee Report

Board Audit Committee

The Board Audit Committee consists of four independent non-executive directors. The members of the Committee are:

Glyn Smith (Chairman of the Committee)
Peter Ayliffe
Bridget Blow
Roger Burnell

The Board is satisfied that Glyn Smith and Roger Burnell have recent and relevant financial experience and are both Chartered Accountants.

The Committee invites the Chief Executive, Finance Director, Chief Risk Officer, General Counsel and Secretary, Chief Internal Auditor and the external auditor to attend meetings on a regular basis. Other senior managers are invited to attend meetings as required. Private meetings are held at least twice a year with the external auditor and annually with the Chief Internal Auditor in the absence of management to enable issues to be raised directly if necessary. The Committee Chairman also meets privately with the Chief Internal Auditor and the external auditor on a regular basis.

Following each Committee meeting, the minutes of the meeting are distributed to the Board, and the Committee Chairman provides an update to the Society's Board on key matters discussed by the Committee.

The responsibilities of the Committee are in line with the provisions of the Financial Reporting Council (FRC) Guidance on Audit Committees. The main function of the Committee is to assist the Board in fulfilling its oversight responsibilities with specific regard to:

- Monitoring the integrity of the interim and annual financial statements and formal announcements relating to financial performance, focusing particularly on significant financial reporting judgements and ensuring the financial statements overall are fair, balanced and understandable.
- Reviewing the adequacy of systems of internal control and the risk management systems.
- Monitoring the external auditor's independence and objectivity, and the effectiveness of the audit process.
- Reviewing the activities and performance of Internal Audit.
- Appointment and remuneration of the Chief Internal Auditor.
- Recommending the appointment and approving the remuneration and terms of engagement of the external auditor.
- Overseeing the Society's whistleblowing arrangements.

In 2015, the Committee met six times and focused on the following matters:

Preparation of financial statements and key areas of judgement

When assessing both the interim and full year 2015 accounts, the Committee considered in detail areas subject to management judgement and received a report from the Finance Director on each area setting out the approach adopted, methodology, key assumptions and comparison with the prior year. Each of the reports presented to the Committee by management was subject to scrutiny by the external auditor. There were no significant disagreements between management and the external auditor. Note 2 to the accounts summarises material judgements and critical accounting estimates made in applying accounting policies, and the sensitivity of reported performance to these judgements and estimates is then set out in subsequent relevant notes. The areas reviewed included:

Effective Interest Rate (EIR) methodology

The Society recognises interest and fee income using a rate of return that reflects a constant income yield over the expected behavioural life of the mortgage loan. This methodology recognises the impact of different interest rates charged over the life of the loan, for example an initial fixed interest rate for a period followed by the Society's Standard Variable Rate. This methodology generally gives rise to an asset in the balance sheet in the early life of a loan that is subsequently amortised. The EIR calculation is most sensitive to future margin assumptions and the level of prepayment that may occur.

The Committee reviewed updated assumptions used for 2015, reflecting the latest experience, together with the impact on the EIR asset of higher levels of redemptions and expectations of future margin compression. The Committee concluded that the basis of calculation and value of the asset was appropriate. Further information can be found in note 3 to the accounts.

Impairment and forbearance

The Committee reviewed in detail the level of provision within the accounts and the range of impairment triggers considered by management. The Committee also considered the basis of calculation of individual and collective provisions, management overlays and details of the forbearance measures utilised by the Society and the approach used to calculate the likelihood and level of any future losses on such accounts. The sensitivity of the provision calculation to various assumptions was considered in light of economic conditions on a business as usual and stressed basis, including an increase in the propensity of accounts to fall into default, and the impact of a fall in house prices. Noting the limited impact of this sensitivity analysis, the modest use of forbearance, the subsequent performance of assets subject to such measures and the general high quality of the mortgage assets, the Committee was satisfied with the adequacy of

Board Audit Committee Report **cont.**

the provisions recorded within the balance sheet. Further information can be found in the retail credit risk section of the Risk Management Report and note 10 to the accounts.

Fair valuations for acquired assets

The Society acquired mortgage assets and retail savings through the merger with Stroud & Swindon Building Society in 2010 and mortgage assets as a result of a loan book purchased from Bank of Ireland in 2012. These items were initially recognised at fair value with subsequent recognition at amortised cost using an EIR methodology. Fair value techniques were used based on observable market data where available, and where not, the Society's internal models used for similar asset classes. The key fair value adjustments recognised were in respect of anticipated credit losses and interest shortfalls, where the yield was lower than corresponding levels in the market. The Committee considered the performance of the assets and the level of fair value adjustments that had been amortised through the Income Statement. Given the consistent performance of the assets, the Committee was satisfied that amortisation in the current period was appropriate. The Committee also considered the impact of the adjustments on the Income Statement and whether year-on-year there was a significant variation that required additional disclosure. It concluded that this was not the case and the Committee was satisfied with the disclosures prepared by management. Further information can be found in note 3 to the accounts.

Hedge accounting

The Committee reviewed the Society's approach to hedge accounting. This included reviewing the different types of hedging adopted by the Society, valuation techniques, sources of accounting ineffectiveness and the key movements during the year. The Committee noted that the Society's application of hedging strategies had remained unchanged during 2015. Whilst cognisant of the risks that can arise from the current accounting requirements, the Committee was satisfied that the approach adopted was appropriate and that the hedging activity undertaken was effective in mitigating the underlying risk. Further information can be found in note 1 to the accounts.

In addition to the areas of management judgement set out above, the Committee also considered the following in relation to the interim and full year accounts:

Interest in structured entity

During the year the Group completed a whole loan sale of its beneficial interest in £0.3 billion of non-member buy to let mortgages originated by its subsidiary, Godiva Mortgages Limited (Godiva), to a third party. The Society acts as servicer for the third party. The Committee reviewed the accounting treatment of this transaction and, taking into account all terms and conditions, concluded that it was appropriate to derecognise these assets in the standalone accounts of Godiva, that the third party entity should not be consolidated in these Group accounts, and that the gain was appropriately calculated. Further information can be found in note 18 to the accounts.

Going concern and long-term viability

The Committee evaluated whether the going concern basis of accounting was appropriate by considering a report presented by the Finance Director which covered profitability, the Society's liquidity position, the availability of funding, regulatory capital considerations and forecast capital ratios. The report also referenced the detailed stress testing undertaken as part of the annual liquidity and capital adequacy assessments. The Committee also considered the Society's longer term viability, taking account of the principal risks facing the Society including those that could threaten the Society's business model, future performance, solvency and liquidity. Further information can be found in the Risk Management Report on page 58.

Fair, balanced and understandable

The Committee considered whether the 2015 Annual Report & Accounts were fair, balanced and understandable. The Committee did this by satisfying itself that there was a robust process of review and challenge at different levels within the Society to ensure balance and consistency, which included:

- Issuing guidance to those involved in drafting or reviewing the Annual Report & Accounts.
- A thorough internal verification process of the factual content of the reports.
- Central coordination ensuring a sufficient cycle of review and adequate review time at each level within the Society.
- Independent review by a non-specialist.
- Comprehensive review by senior management, executives and the Committee Chairman, prior to a meeting of the Audit Committee held to review and consider the Annual Report & Accounts, in advance of the Board's approval.

The Committee also considered other information regarding the Society's performance presented to the Board during the year. After consideration of relevant information, the Committee concluded that it could recommend to the Board that the 2015 Annual Report & Accounts are fair, balanced and understandable.

New accounting standards

Regular updates and training on financial reporting developments were presented to the Committee during the year to enable it to provide effective oversight of the reporting and disclosures within the interim and full year accounts.

During the year the Committee was updated on the progress of the project to implement International Financial Reporting Standard 9 *Financial Instruments,* which will replace International Accounting Standard 39 *Financial Instruments: Recognition and measurement* in 2018. The Committee was satisfied that the project was appropriately advanced at this stage.

Further information with respect to financial reporting developments can be found in note 1 to the accounts.

The Society's internal control and risk management arrangements

The Committee reviewed the effectiveness of internal control and risk management arrangements through regular reporting from Internal Audit and the external auditor. Following a comprehensive Internal Audit review of the Society's risk management framework in 2014, a series of actions have been completed in 2015 to implement a more formal and cohesive approach to risk management. Whilst recognising that the Society's low risk appetite and simple business model are important factors in mitigating risk, the framework implemented is designed to promote risk management, responsibility for risks, and accountability throughout the Society. The implementation process has been substantially completed in 2015 and work to embed the revised framework into business as usual activity will continue into 2016. The Committee received reports on the revised risk management framework and concluded the overall risk management arrangements to be effective.

Further information on the Society's approach to internal control and risk management is included in the Directors' Report on Corporate Governance on page 68.

With respect to the Society's whistleblowing arrangements, the Committee reviewed the whistleblowing policy to take account of the FCA revised rules on whistleblowing, which take full effect in September 2016. It considered an annual report on the operation of the arrangements and a thematic summary of concerns raised and concluded that the arrangements were adequate.

The activities of Internal Audit

The roles and responsibilities of Internal Audit are set out within Internal Audit's terms of reference. These were reviewed and approved by the Committee during the year and a copy is available on the Society's website (thecoventry.co.uk/InternalAudit).

The Committee received regular reports from the Chief Internal Auditor setting out the results of assurance activity, progress in delivery of the Internal Audit plan and the level of resources available. Significant findings and thematic issues identified were considered by the Committee, as well as management's response and the tracking and completion of outstanding actions.

In addition to approving the annual plan and budget, the Committee reviewed and approved amendments to the Internal Audit plan and resources throughout the year. This included approving interim leadership arrangements following the departure of the previous Chief Internal Auditor in April 2015, and the appointment and remuneration of a new Chief Internal Auditor with effect from November 2015.

The effectiveness of Internal Audit was subject to independent external review in 2014. Although the review confirmed that the Internal Audit function was effective at this time, it recommended a number of actions for enhancement and these have been substantially completed during 2015. During the year, the Committee received a report from the Chief Internal Auditor detailing the results of a self-assessment of Internal Audit effectiveness. The report considered conclusions drawn from internal quality assurance processes, stakeholder surveys and independent verification of actions taken in response to the 2014 effectiveness review. The Committee was satisfied that the Internal Audit function remains effective.

Board Audit Committee Report **cont.**

External auditors

As well as discussing the views of the external audit firm on the results of its audit work, the Committee is responsible for oversight of the relationship with the firm and the quality of the audit process. During the year this included the following:

Audit plan

Prior to the annual audit commencing, the Committee considered a report presented by the external auditor, Ernst & Young LLP, which set out the audit plan, planning materiality, areas of audit focus, terms of engagement and fees payable for the audit. Following the review of the interim financial statements and audit of the annual financial statements the Committee received a report setting out: the work performed in areas of significant risk and management judgement and conclusions for each area; a summary of misstatements identified; and internal control related issues. In recommending for approval the interim and annual financial statements the Committee considered the matters set out in these reports.

Audit quality

The Committee maintains oversight of external audit quality. Consideration is given to factors which impact on external audit quality at all Committee meetings, with conclusions on external audit effectiveness being formalised as part of the year end reporting process. The views of members of the Committee, the Finance Director, Internal Audit and key members of the finance team were sought. The factors considered included, but were not limited to:

- The technical skills and industry experience of the audit engagement partner and wider audit team.
- The appropriateness of the proposed audit plan, the identification of significant risk areas and the effective performance of the audit in line with the agreed plan.
- The quality of communication between the external auditor and the Committee and the effectiveness of interaction between management and the external auditor.
- The quality of reports to the Committee on accounting matters, governance and internal control.
- The reputation and standing of the external auditor.
- The independence and objectivity of the external auditor.

The review also considered the FRC's Audit Quality Inspections Annual Report 2014/15 (May 2015) and the Audit Quality Inspections Report on Ernst & Young LLP (May 2015). In addition, the Committee requested representatives from Ernst & Young LLP to present their response to the FRC's findings. The Committee concluded that the external audit process was effective, and it was satisfied that there were no matters of concern with respect to the external auditor's independence or objectivity. The results of the assessment were shared with the lead audit partner so that areas for improvement could be addressed.

Taking into consideration the matters noted above, the Committee has recommended to the Board a Resolution at the 2016 Annual General Meeting that Ernst & Young LLP be reappointed.

The appointment of the external audit firm to undertake non-audit services

The Committee regularly reviews and monitors the Society's relationship with the external auditor to ensure that auditor independence and objectivity is maintained at all times. The Committee has developed a policy and framework which define unacceptable non-audit assignments, pre-approval of certain acceptable non-audit assignments and procedures for approval of other non-audit assignments. At no time does the external auditor audit its own work, make management decisions for the Society, create a conflict of interest or find itself in the role of advocate for the Society. The Committee keeps non-audit engagements under review and receives regular reports from the external audit partner confirming that adequate safeguards remain in place. Furthermore, the Society's policy and framework require that the external auditor should only be appointed if the threat to its objectivity is clearly insignificant, unless appropriate safeguards can be applied to eliminate or reduce such threat to an acceptable level.

During 2015, the Society engaged the external audit firm to provide certain non-audit services. These engagements included other assurance services and advice in relation to accounting, regulatory and taxation matters; all engagements complied with the policy set out above and the Committee received regular updates on the nature and cost of the engagements.

Details of the fees paid to the external auditor for audit and non-audit services are set out in note 8 to the accounts.

Future audit tender

Ernst & Young LLP and its predecessor firms have been the Society's auditors since 1930 when first appointed to audit the Coventry Permanent Economic Building Society's accounts. The lead audit partner rotates at least every five years and the current lead audit partner is due for rotation in 2018. In 2013, the Society tendered its external audit relationship in line with best practice including the most recent FRC guidance at that time. The UK Corporate Governance Code now requires that the audit contract be put out to tender every 10 years, with transitional provisions for compliance meaning that the contract must be re-tendered no later than 2019 for the 2020 year end audit. Based on these factors, the Committee has recommended to the Board that, subject to implementation of the European Union Directive, a tender of the external audit should commence in 2017 with respect to the 2018 audit. Ernst & Young LLP will not be invited to re-tender based on guidance under the new rules.

The effectiveness of the Committee

The Committee carried out a review of its effectiveness during 2015, including an assessment of its work against its terms of reference, published guidance and best practice. The review was facilitated by Internal Audit and considered questionnaires which were completed by both Committee members and regular attendees. The review concluded that the Committee had operated effectively throughout the year.

Glyn Smith
Chairman of the Board Audit Committee
25 February 2016

Directors' Remuneration Report

Dear Member

I am pleased to present the Remuneration Committee's annual report, which sets out the directors' remuneration for the year ending 31 December 2015 and the remuneration policy for 2016. In line with our values, we work hard to make sure that this report is straightforward, giving you information which is clear and easy to follow. There are two sections to the report – a Remuneration Policy Report, which sets out the Society's remuneration policy for directors; and the Annual Remuneration Report, which outlines how the 2015 policy was implemented during the year.

We understand the importance of controlling costs. Indeed, it is a key factor in ensuring that we can continue to offer competitive rates to savers and borrowers. We must also attract and retain people with the right skills, knowledge and attitude to work across the Society, from the directors who determine and lead the strategy, to the employees in our branches and contact centre whose excellent service you so often compliment us upon. Our approach to determine pay reflects the need to strike this balance.

The directors

The Society has benefited during 2015 from a stable board of directors, with the only change being the departure of the Chief Risk Officer (Feike Brouwers) in March. Details of the Society's directors are included on pages 60 to 62.

The Society's performance

2015 saw the Society sustain strong member-focused performance. We continue to deliver a strategy of long-term value for our members based on low cost operations, low risk lending and high quality service. This provides the basis for strong but appropriate levels of profitability, sustainable growth and a secure capital position.

Remuneration in 2015

Full details of the directors' remuneration, both the fixed elements of salary and the variable elements of remuneration, can be found in this report. The only material change introduced during 2015 was the introduction of a provision allowing the Society to clawback performance pay awards for up to seven years after they were awarded. This provision is in line with our regulatory obligations.

The approach taken to determining directors' pay for 2015 was aligned to the approach taken to setting pay across the wider Society. Under this approach, we considered affordability, the need to pay fairly and competitively, and any exceptional changes that have occurred in an individual's role. Total base salaries for the directors increased by 5.2% during 2015; and the bonus and long term incentive schemes for the performance periods ending 31 December 2015 paid out at 12% (from a potential maximum of 20%) and 40% (from a potential maximum of 40%) of base salary for eligible executive directors, respectively.

2016 Remuneration Policy

Plans for 2016 remuneration are currently being considered. Changes will be required to the Long Term Incentive Plan (LTIP) to ensure compliance with new regulations that increase deferral to seven years for some of the directors. We are also taking the opportunity to review the structure of directors' remuneration to determine whether any wider changes are required. Any decision taken will reflect our commitment to the spirit of the regulations and will be in line with our values.

An advisory vote in respect of the resolution to approve the Annual Remuneration Report for 2015 on pages 81 to 86 will be retained as for 2014.

Ian Geden
Chairman of the Remuneration Committee
25 February 2016

Remuneration Policy Report

This report informs members of the policy for the remuneration of both executive and non-executive directors, who are equally responsible for directing the Society's affairs. This report does not form part of the Directors' Remuneration Report on which members vote.

The Society's Remuneration Policy is designed to ensure that executive directors' remuneration focuses on rewarding directors for their responsibilities, performance and experience, within a market competitive range. Remuneration packages aim to aid the recruitment, retention and motivation of high calibre individuals to lead and direct the Society and deliver continuously improving performance and long-term sustainability for our members.

The remuneration of directors is in line with the business strategy, objectives, values and long-term interests of the Society and with the Prudential Regulation Authority's (PRA's) Remuneration Code. The remuneration policy is consistent with the overall financial stability of the Society, promotes sound and effective risk management and does not encourage excessive risk taking.

The main elements of remuneration currently in place for executive directors are set out below, with an explanation of how each element links to our overall business strategy:

	Element	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics
Fixed remuneration	Base salary	Core element of fixed remuneration with the aim of recruiting, retaining and motivating high calibre executives at the level of responsibilities, experience and performance required.	Salaries are reviewed annually (more frequently where required) with regard to a number of factors, including role, experience and individual performance; the economic environment and the Society's financial performance; and within market competitive ranges.	Salary increases are assessed in line with other employees. Higher increases may be awarded where there is a rationale to do so, for example an increase in scope or responsibility, or a new director being benchmarked against the external market.	Not applicable.
Fixed remuneration	Benefits	Element of fixed remuneration with the aim of recruiting, retaining and providing security for executive directors.	Each executive director receives benefits broadly in line with the market, such as a company car or a cash alternative, private fuel, membership of a private medical insurance scheme and life insurance. Other benefits may be provided on an individual basis, such as relocation allowances.	Benefits are set at a level to be appropriate according to individual circumstances.	Not applicable.
Fixed remuneration	Pension	Provides post-retirement benefits for participating executive directors at a sustainable level of cost for the Society.	Executive directors are eligible to participate in the defined contribution pension plan. In some circumstances, such as where contributions exceed the annual or lifetime allowance, executive directors may be permitted to take a cash alternative in place of contributions.	A pension contribution or cash supplement of up to 20% of base salary is made to executive directors. For the Chief Executive this is currently 20%, and for other executive directors this is currently 15% of base salary.	Not applicable.

Directors' Remuneration Report **cont.**

	Element	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics
Variable remuneration	Annual bonus	Rewards performance linked to the achievement of corporate targets for a single financial year. Supports the attraction and retention of executive directors and the development of a strong performance culture.	Executive directors are eligible to participate in the same annual bonus scheme as provided to all Society employees. Awards to executive directors are made in cash, half of which is currently paid in the March following the financial year under review after approval of the accounts, and the remainder of which is retained in an equivalent share-like instrument for a further six months. During the retention period the retained element can move both up and down in value. For the upward movement, the retained element of variable remuneration will be indexed and increase in line with the Retail Prices Index to preserve the real terms value of the award. It can move down based on the performance of the Society post vesting. The retained award will reduce in the event that capital strength or profit declines significantly, as would be the case for a decline in the share price of a listed firm. The scheme is reviewed each year in light of business plans and changes in regulation.	Maximum award for executive directors, as for all employees, is currently 20% of base salary as at 31 December of the performance year. If profit plans are achieved, the scheme allows for an award of 10% of base salary to be made; if profit plans are not met, there is no award. The Committee has absolute discretion to adjust or recover awards if necessary, including withholding vested awards under 'malus' arrangements and recovering payments made under 'clawback' arrangements.	Performance is measured against appropriate financial and non-financial targets.
	Long Term Incentive Plan (LTIP)	Aims to ensure a strong link between remuneration and the interests of members through long-term sustainable performance that supports the achievement of Society goals. Provides a balance between long and short-term rewards in the overall remuneration of participating executive directors.	Executive directors are eligible to participate in the LTIP. The 2016 scheme is under review but will continue to meet the deferral requirements of the PRA's Remuneration Code, which for 2016 schemes will extend from three to seven years for some executive directors. Awards are currently made in cash, half of which is currently paid in the March following the end of the performance cycle and the approval of the accounts for the final year, and the remainder of which is retained in an equivalent share-like instrument for a further six months, when the award may be subject to adjustment as for the annual bonus scheme, outlined above. The scheme is reviewed each year in light of business plans and changes in regulation.	Maximum award for executive directors is 40% of base salary at the time the LTIP is granted. If the threshold is achieved, the scheme allows for an award of 20% to be made; no award will be made if the threshold is not met. The Committee has absolute discretion to adjust or recover awards if necessary, including withholding vested awards under 'malus' arrangements and recovering payments made under 'clawback' arrangements.	Performance is measured against appropriate challenging financial targets. The Committee also assesses the Society's non-financial performance in a number of areas, economic conditions and individual performance, and modifies the award as appropriate.

The clawback, malus, deferral and retention arrangements are in place for executive directors and senior managers, in compliance with the PRA's Remuneration Code and best practice. It is the Committee's view that the approach to assessing performance, including the variable pay performance measures, provides an objective assessment of business risk and long-term sustainability, which forms the basis on which the Committee decides to adjust variable pay scheme payments.

Further details about clawback and malus arrangements are set out below.

	Malus	Clawback
What is it?	Malus is where the Remuneration Committee may decide to reduce or cancel any payment under the Society's variable pay schemes, before payment has been made.	Clawback is where the Society requires an individual to repay all or part of a variable pay award after payment has been made.
Which awards does it apply to?	Malus applies to payments that may be made under the current annual bonus and LTIP schemes and any future variable pay schemes.	Clawback applies to payments made under the 2015 annual bonus and 2015-2017 LTIP scheme and any future variable pay schemes. Awards are subject to clawback for up to seven years (up to ten years from 2016 schemes) and will continue to apply should an individual leave the Society.
When would this be used?	The Remuneration Committee may consider malus is appropriate in circumstances including but not limited to: • There is reasonable evidence of misbehaviour or material error by the executive director. • The Society suffers a material downturn in its financial performance. • The Society suffers a material failure of risk management.	The circumstances in which the Remuneration Committee may require clawback to be applied include: • There is reasonable evidence of misbehaviour or material error by the executive director. • The Society or function suffers a material failure of risk management. • By virtue of a material misstatement of the Society's financial results, the payment made under the variable pay arrangement was greater than it would have been but for the misstatement.

The Committee is clear that it is essential that variable remuneration awards are not excessive, and variable pay awarded in respect of a financial year is currently limited to a maximum of 60% of fixed pay, which is under the fixed to variable pay cap of 100% set out in the Capital Requirements Regulation and Capital Requirements Directive (CRD IV). The minimum variable remuneration is nil.

Explanation of performance metrics chosen for executive directors' variable remuneration

The Society operates two variable pay schemes for executive directors:

- The annual bonus scheme, which rewards performance over a single financial year and is the same scheme for all employees.
- The LTIP, which is the deferred element of variable pay and rewards performance over the longer-term.

When reviewing variable pay schemes, the Committee considers target ranges taking into account budget expectations, growth forecasts and long-term stability. Performance modifiers are set to discourage excessive risk taking and to take into consideration customer and member outcomes; no weightings are currently attached to scheme performance modifiers.

To protect the interests of members, the Committee may amend any award if it considers it appropriate in light of either the Society's overall performance or economic conditions or any other factors the Committee feels are relevant including, but not exclusive to, individual and business unit performance.

Directors' Remuneration Report **cont.**

The following table shows the different levels of potential variable pay as a percentage of base salary, benefits and pension:

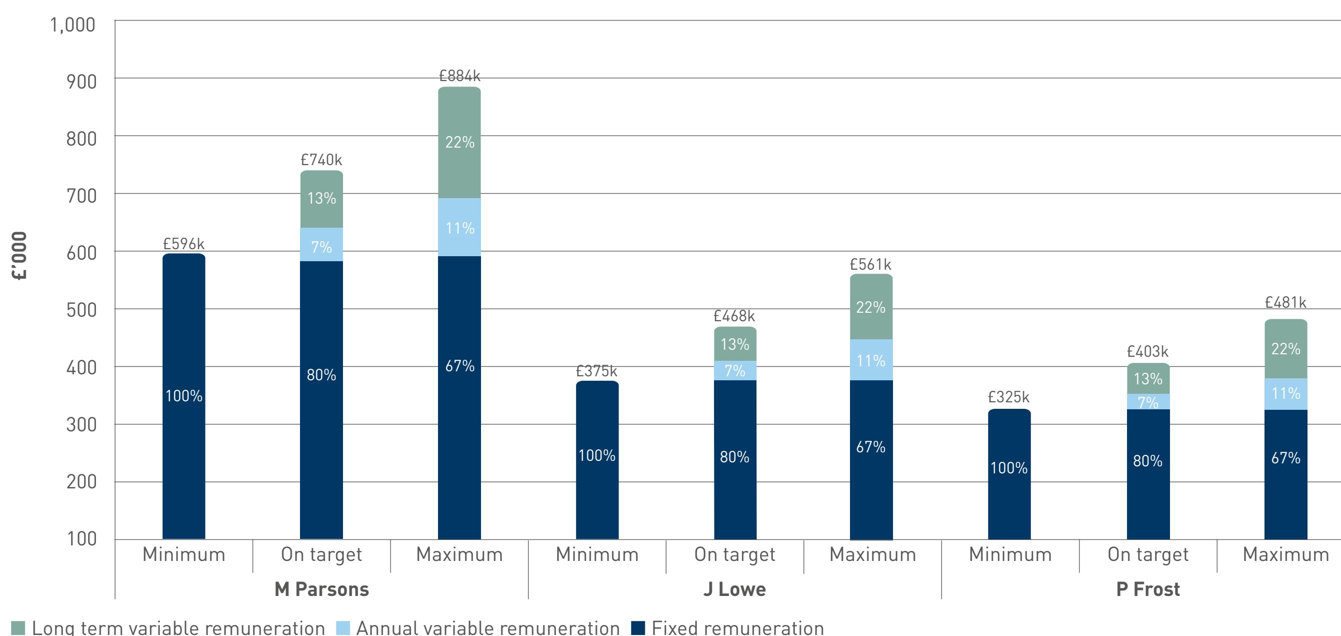
	As a percentage of base salary		
2016 Performance scenarios	Annual bonus %	LTIP %	Total variable remuneration %
Minimum	0	0	0
On target	10	20	30
Maximum	20	40	60

Illustration of the application of the Remuneration Policy

The graph below illustrates what the executive directors could earn based on the Remuneration Policy based on 2015 remuneration levels and three potential performance scenarios – minimum, on target and maximum variable remuneration. Under the variable remuneration schemes, thresholds need to be achieved to generate a 'target' award and considerably exceeded to generate a maximum award. The long-term variable element would not be paid until after the end of the performance period.

In applying the scenarios, the following assumptions have been made:

- Fixed remuneration refers to current base salary, pension as a percentage of base salary, and benefits paid over the course of the calendar year. Benefits figures are taken from those disclosed in the single figure table on page 81.
- The element of the annual bonus and LTIP retained in an equivalent share-like instrument (50%) is shown before any adjustment has been applied.



Approach to recruitment remuneration

When agreeing the elements of a remuneration package for the appointment of executive directors, the Committee will consider the following:

- The package required to enable the recruitment of high calibre executives for the level of responsibilities, experience and performance required without being excessive.
- Comparison with similar positions within the Society's close peer group of building societies and other organisations of a similar size and complexity.
- Alignment with the existing packages offered within the Society's remuneration policy, including maximum variable pay limits.

The Committee may also make awards on hiring an external candidate to compensate them for forfeiting any awards foregone from a previous employer. In determining any such 'buyout', the Committee will consider all relevant factors, including the likelihood of the awards vesting had the candidate remained in their previous employment, the form in which they were awarded and the time over which they would have vested, and seek to implement any 'buyout' or recruitment awards in line with the Remuneration Policy wherever possible. The Society will always comply with regulatory requirements in effect at the time of making any awards of this nature.

Service contracts

Executive directors' terms and conditions of employment are detailed in their individual service contracts, which are available at the Principal Office. Contracts are terminable by the director on six months' notice and by the Society on one year's notice. The dates individuals were appointed as executive directors to the Society are shown in the table below:

Executive director	Date of appointment as a director of the Society
Chief Executive – Mark Parsons	1.7.2014
Finance Director – John Lowe	14.10.2010
Chief Operating Officer – Peter Frost	1.11.2012

All directors are subject to election by members, generally at the Annual General Meeting (AGM) following their appointment by the Board and, with effect from the 2015 AGM, will stand voluntarily for re-election each year.

Policy on payment for loss of office

The Society's approach to determining payments for the loss of office of executive directors is summarised as follows:

Termination payments will include payment of any base salary or other contractual benefits due for the notice period, although this may be reduced if alternative employment is found during any period of garden leave.

The annual bonus and LTIP will be paid according to the leaver provisions within the scheme rules and is dependent on whether the executive director is deemed a good leaver. A good leaver is an individual who ceases to be a director either due to death, ill-health, injury or disability, or any other reason as determined by the Committee.

Under good leaver circumstances, the scheme rules state that any annual bonus or LTIP award will usually be pro rata to the time served during the performance period. Any deferral and retention requirements will be applicable and amounts will be subject to any necessary adjustment and payable at the same time as it would be for executive directors remaining in employment. Clawback rules will continue to apply. If an individual is deemed not to have left under good leaver circumstances, no annual bonus payments will be made and unvested LTIP awards will lapse.

Other considerations when setting executive director remuneration

When approving executive director pay, the Committee will take into account remuneration paid to other employees across the Society, including the salary increases awarded and consideration of the Remuneration Policy as applied to the wider employee group.

All eligible employees participate in the discretionary annual bonus scheme. Eligibility is dependent upon satisfactory individual performance, although the amount paid is determined by the performance of the Society as a whole. It applies to all employees on the same terms, including executive directors. It does not apply to non-executive directors. Participation in the LTIP scheme includes members of senior management, with their maximum award capped at 20% of base salary.

Directors' Remuneration Report **cont.**

Non-executive directors

The basis of non-executive directors' remuneration is set out below:

Element	Purpose and link to strategy	Operation
Non-executive director fees	Only element of remuneration, set at a level that reflects the market and is sufficient to attract individuals with appropriate knowledge and experience to support the Society progress its strategy.	Non-executive directors receive a base fee and an additional fee for chairmanship of a committee and/or holding the position of Senior Independent Director or Deputy Chairman and are reimbursed for reasonable expenses, paid in accordance with the Society's Rules. The non-executive directors do not participate in any Society pension or bonus arrangements. Fees are reviewed annually with regard to the Society's financial performance; annual pay increases awarded to executive directors and other employees; and within market competitive ranges.

Letters of appointment

Non-executive directors are appointed by letter of appointment for an initial term of three years, which is terminable at the discretion of the Board or of the director concerned. All directors are subject to election by members, generally at the AGM following their appointment by the Board, and with effect from the 2015 AGM, will stand voluntarily for re-election each year.

Consideration of member views

The Society has dialogue with members and welcomes feedback on executive and non-executive directors' remuneration. At the 2015 AGM, 93.1% of members voted in favour of the approval of the 2014 Directors' Remuneration Report.

Annual Remuneration Report

This report informs members of the remuneration awarded to both executive and non-executive directors relating to 2015. It is this report on which members have an advisory vote.

Taking into account pension and other benefits, the total pay package awarded to current executive directors is shown below:

Audited information: Single total figure of remuneration for each executive director:

	Base salary £000	Taxable benefit £000	Annual bonus £000	LTIP £000	Pension allowance[1] £000	Loss of office £000	Total £000
2015							
Mark Parsons	475	19	57	–	95	–	646
John Lowe	309	16	37	104	43	–	509
Peter Frost[2]	255	79	31	88	35	–	488
Feike Brouwers[3]	87	3	–	–	8	73	171
Remuneration as a director	64	2	–	–	6	–	72
Remuneration as an employee	23	1	–	–	2	73	99
Total	1,126	117	125	192	181	73	1,814
2014							
Mark Parsons (appointed 1.7.2014)	230	10	28	–	46	–	314
John Lowe	296	14	36	88	30	–	464
Peter Frost	236	25	29	64	24	–	378
Feike Brouwers[3]	255	9	15	67	25	–	371
Total	1,017	58	108	219	125	–	1,527

1. Pension allowance includes both contributions to the Group's defined contributory pension scheme and cash payments in lieu of contributions.
2. Peter Frost's taxable benefits include £52,000 for payments agreed under his contract of employment to enable his relocation to the Coventry area. This has been excluded from the illustration on page 78.
3. Feike Brouwers resigned as an executive director on 31 March 2015. He continued in the role as Chief Risk Officer as an employee. He commenced garden leave from 30 April 2015. Loss of office includes remuneration due to the end of his garden leave (9 August 2015). He received half of the 2014 annual bonus, and the full amount due to him awarded under the 2012-2014 LTIP. All amounts relating to future annual bonus and LTIPs, including those vesting at the end of 2015, were forfeited.

No director has received payments in excess of €1,000,000 during 2015 or 2014. Payments to former directors are disclosed on page 83.

Further information on individual remuneration elements: executive directors

Base salary

The annual review of salaries conducted in April 2015 saw an average increase of 5.2% for eligible executive directors and 3.9% for employees. The Chief Operating Officer's role was extended during the year and the Chief Executive's increase was part of a contractual arrangement and not the annual review process. Approximately a quarter of the Society's employees are covered by competency related pay progression schemes, which allow for additional increases to pay in line with increasing skills. In setting salary increases, the Committee considered the results of the Society's annual benchmarking exercise, together with the financial performance of the Society and individual executive director performance and experience.

The table below sets out the current base salary for the chief executive, compared with the base salary in effect from his start date in 2014:

Executive director	2015/16 £	2014/15 £	% increase
Mark Parsons	480,000	460,000	4.3

For 2016, the base salaries for executive directors will be revised from April 2016 and are anticipated to be set in line with the approach outlined in the Remuneration Policy Report.

Directors' Remuneration Report **cont.**

Annual bonus 2015

The Society performed strongly in 2015, meeting key corporate strategic objectives for the period. The profit threshold was achieved for the annual bonus for 2015. Details of performance against the financial and non-financial modifiers, such as performance and growth, risk and compliance, customer experience, human resources and community, are set out in the Strategic Report section of the Annual Report & Accounts (pages 2 to 58). No weightings are currently attached to scheme performance modifiers.

In determining the annual bonus award to employees and executive directors, the Committee considered the level of annual bonus awards given the above modifiers. This gave rise to a bonus for all 2,101 eligible employees equivalent to 12% of base salary from a potential maximum of 20%. The bonus percentage payable to each of the executive directors is the same as for all other eligible employees.

For executive directors and other senior managers 50% of the annual bonus will be retained in an equivalent share-like instrument for a further six months. This will be paid at the end of the retention period, subject to adjustment, as outlined on page 76 and Committee discretion.

The 2016 annual bonus scheme has been reviewed in line with business strategy and changes to relevant regulation. There is no change to the maximum award achievable.

Long Term Incentive Plan (2013-2015)

The Society achieved strong results throughout the period of assessment and met the targets set in its plans for the period. The Society significantly exceeded the scheme maximum of £185.8 million profit in the final year of the scheme (before FSCS charges) and has seen strong performance against the measures for financial performance and growth, risk and compliance, customer experience, human resources and community. Further information in respect of this performance is provided in the Strategic Report section of the Annual Report & Accounts (pages 2 to 58).

This resulted in a maximum award under the scheme to each participant of 40% of base salary for eligible executive directors and 20% of base salary for senior management. Base salary is set as the salary for each participant at the date of the original 2013 grant. The Chief Executive was not eligible for an award having joined after the date of grant. No targets were adjusted from those originally set when the grant was made in 2013.

Awards included those to the former Chief Executive and Deputy Chief Executive on a pro rata basis, as good leavers of the scheme; and to the Finance Director and Chief Operating Officer.

50% of the payments made under the LTIP will be retained in an equivalent share-like instrument for a further six months. This will be paid at the end of the retention period, subject to an adjustment as defined on page 76 and Committee discretion.

A new LTIP was granted to executive directors and other senior managers in 2015 for the performance period 2015-2017. The maximum award for participants is 40% of base salary for executive directors and 20% of base salary for senior managers. If the threshold is achieved, the scheme allows for an award of 20% to be made; no award will be made if the threshold is not met. The performance conditions are based on achieving final year Strategic Plan profit before tax and exceptional items, less charitable donations. When determining awards, additional financial and non-financial measures will be assessed, as outlined in the Remuneration Policy Report.

The 2016-2018 LTIP will be reviewed to ensure compliance with new regulations that increase deferral from three to seven years for some of the directors. The Committee are also taking the opportunity to review the structure of directors' remuneration to determine whether any wider changes are required.

The maximum award levels under the variable award schemes are shown below:

	Maximum award levels (% of base salary)			
	Annual bonus 2015 %	Annual bonus 2014 %	LTIP 2015-2017 %	LTIP 2014-2016 %
Executive directors	20	20	40	40

Benefits and pension

Executive directors received benefits including a fully expensed car, including private fuel, or a cash alternative, personal membership of a private medical insurance scheme and life insurance.

Executive directors were eligible to participate in the defined contribution pension plan (Group Personal Pension scheme) which is offered to all employees and is pensions auto-enrolment compliant.

The Finance Director is an active member of the Group's defined contribution pension scheme and received a combination of contributions and cash payment in lieu equivalent to 15% of base salary.

For the Chief Executive and Chief Operating Officer, pension contributions are cash payments equivalent to 20% and 15% respectively of base salary in respect of the value of pension benefits foregone.

No changes are anticipated to the Society's approach to pension and benefit provision in 2016.

Payments to former directors (Audited information)

David Stewart tendered his resignation as Chief Executive Officer in 2013, and left the Society on 31 March 2014. The Committee determined David Stewart to be a good leaver in recognition of his significant contribution to the successful performance and growth of the Society during a challenging period for the financial services sector and wider economy and he is therefore eligible to receive a payment under the 2013-2015 LTIP pro rata to his period of employment with the Society. He is also eligible to receive a payment under the 2014-2016 LTIP on a pro rata basis up to a maximum value of £14,333. Any award due will vest in line with those for executive directors remaining in employment with the Society, including any retention and discretion adjustments.

Colin Franklin stepped down from his role as Deputy Chief Executive on 30 September 2014 but remained as an employee of the Society in an advisory role until 15 December 2014, after which he continued to be remunerated on his then current salary until the end of his notice period (15 June 2015).

The Committee determined Colin Franklin to be a good leaver due to his retirement after a long period of employment with the Society and he is therefore eligible to receive a payment under the 2013-2015 LTIP pro rata to his period of employment with the Society. He is also eligible to receive a payment under the 2014-2016 LTIP on a pro rata basis up to a maximum value of £46,667. Any award due will vest in line with those for executive directors remaining in employment with the Society, including any retention and discretion adjustments. From July 2015, Colin Franklin also received a fee of £12,500 in relation to his role as chairman of the pension trustees for the Society's defined benefit pension scheme.

Audited information: Single total figure of remuneration for each former executive director:

	Base salary £000	Taxable benefit £000	Annual bonus £000	LTIP £000	Pension allowance £000	Increase in accrued pension £000	Loss of office £000	Total £000
2015								
David Stewart	–	–	–	65	–	–	–	65
Colin Franklin	–	–	–	47	–	–	–	47
Total	–	–	–	112	–	–	–	112
2014								
David Stewart[1]	107	5	13	102	27	1[2]	278	533
Colin Franklin[3]	229	17	31	56	34	–[4]	148	515
Remuneration as a director	181	12	23	56	27	–	–	299
Remuneration as an employee	48	5	8	–	7	–	148	216
Total	336	22	44	158	61	1	426	1,048

1. David Stewart's salary, taxable benefits, annual bonus, LTIP and pension allowance are those up to the date on which he ceased to be a director - 31 March 2014.
2. David Stewart made no contribution to the defined benefit pension scheme during 2014. Accrued pension per annum as at 31 December 2014 was £44,000. The normal retirement age is 60. If early retirement is taken, the accrued pension will be adjusted accordingly. There was no entitlement to any additional benefits.
3. Colin Franklin stood down from the Board on 30 September 2014 and the table reflects his remuneration as an executive director, including an additional allowance while he undertook the role of Interim Chief Executive, as well as his ongoing advisory role as an employee until 15 December 2014. Loss of office includes remuneration due to the end of his notice period (15 June 2015).
4. In line with pension scheme rules, Colin Franklin elected to receive pension payments from 1 April 2014 and an early retirement adjustment was applied which reduced the accrued pension figure. No increase in accrued pension is therefore shown in the table above. He made no contributions to the defined benefit pension scheme during 2014. Accrued pension per annum as at retirement (31 March 2014) was £67,000. There was no entitlement to any additional benefits.

There were no other payments made to former directors in relation to past service during the financial year ending 31 December 2015.

Recruitment remuneration

No new executive director was recruited during 2015.

Directors' Remuneration Report **cont.**

Change in remuneration of director undertaking the role of Chief Executive

The historical levels of the Chief Executive's annual bonus and LTIP awards as a percentage of the maximum payable are shown in the table below:

	2015 %	2014 %	2013 %	2012 %	2011 %	2010 %
Current Chief Executive						
Annual bonus as a percentage of maximum	60	60	–	–	–	–
LTIP as a percentage of maximum	–	–	–	–	–	–
Former Chief Executive						
Annual bonus as a percentage of maximum	–	60	70	60	65	55
LTIP as a percentage of maximum	–	100	100	97	38	38

Relative importance of spend on pay

The following table sets out the percentage change in profit and overall spend on remuneration in the year ended 31 December 2015, compared with the year ended 31 December 2014:

	2015 £m	2014 £m	Percentage change %
Profit after tax	171.3	158.5	8.1
Employee remuneration costs	61.6	57.8	6.6
Headcount (number)	2,146	2,065	3.9

Audited information: Non-executive directors' emoluments

	Base fees		Committee Chair fees		Taxable benefits		Total fees and taxable benefits	
	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000	2015 £000	2014 £000
Non-executive directors:								
Ian Pickering (Chairman)	136	133	–	–	6	4	142	137
Janet Ashdown	46	45	–	–	2	2	48	47
Peter Ayliffe	46	45	–	–	3	1	49	46
Bridget Blow (Deputy Chairman; Senior Independent Director - until 31.12.15; and Chairman of the Remuneration Committee - until 31.12.15)	46	45	17	16	–	–	63	61
Roger Burnell (Chairman of the Board Risk Committee; and Senior Independent Director - from 1.1.16)	46	45	13	12	–	–	59	57
Ian Geden (Chairman of the Remuneration Committee – from 1.1.16)	46	45	–	–	2	1	48	46
Glyn Smith (Chairman of the Board Audit Committee and Models and Ratings Committee)	46	45	23	23	5	3	74	71
Total	412	403	53	51	18	11	483	465

Further information on individual remuneration elements: Non-executive directors

Fees

A Non-Executive Directors' Remuneration Committee reviews the fees of the non-executive directors annually in light of their responsibilities and within market competitive ranges and recommends to the Board for approval the remuneration of the non-executive directors, other than the Chairman. Recommendations for the remuneration of the Chairman are made by the Remuneration Committee and approved by the full Board without the participation of the Chairman. No director takes part in the discussion of his or her own remuneration.

The fees for non-executive directors were increased from January 2015. The table below sets out the fee levels for non-executive director roles which were in effect during the year compared with the previous year. Non-executive director fees are made up of a base fee, plus a Committee Chair fee as appropriate. The Chairman does not receive additional fees for roles carried out other than that of Chairman.

Role	2015 £000	2014 £000
Chairman	136	133
Base fee	46	45
Deputy Chairman	6	6
Remuneration Committee Chairman	10	10
Board Audit Committee Chairman	13	12
Board Risk Committee Chairman	13	12
Models and Ratings Committee Chairman	10	10
Senior Independent Director (if different from Deputy Chairman)	6	6

For 2016, the fees for non-executive directors will be reviewed during 2016 and any increase backdated to 1 January 2016.

Taxable benefits

Taxable benefits are amounts relating to the reimbursement of travel and accommodation expenses in relation to attendance at meetings held in the Coventry head office.

Non-executive directors do not participate in any performance related pay or bonus schemes, pension arrangements or other benefits.

Aggregate remuneration data disclosure under CRD IV

These additional disclosures focus on the remuneration policies and practices for employees who have a material impact on the Society's risk profile (Material Risk Takers). Material Risk Takers consist of executive directors, non-executive directors, certain senior managers in control functions (for example, Audit, Risk and Compliance) and other Material Risk Takers.

The Capital Requirements Regulation (CRR) as part of CRD IV requires the Society to disclose aggregate remuneration data for all Material Risk Takers. The remuneration relevant to Material Risk Takers, comprising senior management and other Material Risk Takers, was as follows for 2015 and 2014:

	Aggregate remuneration data for Jan-Dec 2015			Aggregate remuneration data for Jan-Dec 2014		
Material Risk Takers	Number of employees	Fixed pay £m	Variable pay[1] £m	Number of employees	Fixed pay £m	Variable pay[1] £m
Senior managers[2,3]	19	3.3	0.9	18	2.9	0.9
Other Material Risk Takers[2]	38	3.0	0.3	32	2.7	0.3
Total	57	6.3	1.2	50	5.6	1.2

1. Variable pay includes the annual performance related bonus (£0.5 million) for 2015 (paid March 2016) (2014: £0.5 million paid March 2015), the LTIP 2015-2017 payment granted (not paid) in 2015 (£0.6 million) (LTIP 2014-2016 payment granted (not paid) in 2014 (£0.7 million)) and a guaranteed bonus paid to one senior manager totalling £18,000, in compensation for bonuses foregone on leaving previous employer. The LTIP payment included above is the maximum possible under the scheme (40% executive directors and 20% senior managers of base salary as at the grant date); the actual payment will be subject to the performance criteria outlined on page 77.
2. Senior managers comprise non-executive directors, executive directors and certain senior managers. All other relevant employees are classified as other Material Risk Takers.
3. Severance payments were made to two senior managers during 2014, totalling £0.4 million.

Directors' Remuneration Report **cont.**

Details of the Remuneration Committee

The Remuneration Committee consists of independent non-executive directors and the Board Chairman. The members of the Committee are:

Ian Geden (Chairman of the Committee from 1 January 2016)
Janet Ashdown
Bridget Blow (Chairman of the Committee until 31 December 2015)
Ian Pickering

The Remuneration Committee has delegated authority from the Board to:

- Review and approve the Society's Remuneration Policy Statement.
- Approve the remuneration of the executive directors and, in consultation with the Chief Executive, senior management.
- Oversee the remuneration of all other Material Risk Takers.
- Approve all performance related pay schemes together with relevant targets.
- Review the remuneration of the Chairman for recommendation to and approval by the Board.
- Review and approve the Directors' Remuneration Report.

No director takes part in the discussion of his or her own remuneration.

The Committee met seven times during the year to consider matters within its remit. The outcomes of the Committee's work are set out in this report.

Details of the Non-executive Directors' Remuneration Committee

The members of the Committee are:

Mark Parsons (Chairman of the Committee)
John Lowe
Ian Pickering

The Committee is responsible for reviewing and recommending to the Board for approval the remuneration of the non-executive directors, other than the Chairman.

Non-executive directors do not participate in the Society's performance related bonus schemes.

The Committee met four times during the year to conduct the annual remuneration review and carry out other activities within its remit.

Further information on the dates of appointment of the non-executive directors is included in the Annual Business Statement (page 138).

Remuneration Committee advisors and fees

The Remuneration Committee considers external data from independent national surveys of the financial services sector, FTSE 250 companies and a comparator group of financial institutions to ensure remuneration remains competitive. The Committee also considers regulatory compliance, best practice for remuneration (for example, deferral) and market practice.

Deloitte LLP (Deloitte) was appointed by the Committee and is retained to provide independent advice to the Committee as required. Deloitte is a founding member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. As well as advising the Remuneration Committee, Deloitte also provided tax, internal audit, risk, liquidity and pension audit services to the Society during the year. The Committee is satisfied that the advice received is objective and independent and services provided by Deloitte are reviewed annually to ensure this continues to be the case. Deloitte's fees for providing advice to the Committee amounted to £91,000 (including VAT) for the year ended 31 December 2015.

Directors' Report

The directors have pleasure in presenting their Annual Report & Accounts for the year ended 31 December 2015.

Business objectives

The Society exists solely for the benefit of its current and future members, meeting their needs for savings and residential property mortgages. In delivering its strategic objectives, the Society is committed to Putting Members First in everything it does and fully embraces the mutual ethos on which the Society was founded.

Business review, future developments and key performance indicators

The Group's business and future plans are reviewed in the Strategic Report section of the Annual Report & Accounts (pages 2 to 58). The Group's principal key performance indicators are detailed in the Business Review.

Profit and capital

Profit before tax for the year ended 31 December 2015 was £216.0 million (2014: £201.8 million). The profit after tax transferred to the general reserve was £171.3 million (2014: £158.5 million).

Total Group reserves and equity at 31 December 2015 were £1,651.5 million (2014: £1,490.9 million). Further details on the movements on reserves and equity are given in the Group Statement of Changes in Members' Interests and Equity (page 98).

Gross capital at 31 December 2015 was £1,871.3 million (2014: £1,710.7 million) including £58.2 million (2014: £58.2 million) of subordinated debt, £161.6 million (2014: £161.6 million) of subscribed capital and £396.9 million (2014: £396.9 million) of Perpetual Capital Securities. The ratio of gross capital as a percentage of savings and borrowings at 31 December 2015 was 5.90% (2014: 5.90%) and the free capital ratio was 5.77% (2014: 5.78%). The Annual Business Statement gives an explanation of these ratios (see page 137).

Mortgage arrears

At 31 December 2015, there were 141 mortgage accounts more than 12 months in arrears (including those in possession) (2014: 235). The balance on these accounts totalled £21.3 million (2014: £32.9 million) and the value of these arrears was £1.9 million (2014: £2.9 million) or 0.01% (2014: 0.01%) of total mortgage balances. The mortgage arrears methodology is based on the Council of Mortgage Lenders' definition, which calculates months in arrears by dividing the arrears balance outstanding by the latest contractual payment.

Charitable and political donations

The Board approved donations of £1.9 million (2014: £1.8 million) to charitable organisations during the year. This included an amount of £1.7 million (2014: £1.7 million) to The Royal British Legion's Poppy Appeal, £60,000 (2014: £60,000) to the Coventry Building Society Charitable Foundation and £140,000 to Cancer Research UK from the Society's Race for Life Bond.

No contributions were made for political purposes. Time allowed for employees to carry out civic duties and political activity can amount to a donation. The Society supports a small number of employees in this way.

Creditor payment policy

The Society's policy is to agree the terms of payment at the start of trading with suppliers and to pay in accordance with its contractual and other legal obligations. The Society's creditor days were 14 days as at 31 December 2015 (2014: 11 days).

Country-by-country reporting

The nature of activities of the Society are set out under Business objectives above and for each of the Society's subsidiaries in note 17 to the accounts. All of the activities of the Society and its subsidiaries are conducted in the United Kingdom, and therefore 100% of the total income, profit before tax and tax shown in the Income Statement, as well as employee figures disclosed in note 9 to the accounts, are related to the United Kingdom. The Society and its subsidiaries have not received any public subsidies.

Directors' Report **cont.**

Risk management

As a result of its normal business activities, the Group is exposed to a variety of risks, including credit, market, liquidity and funding, conduct, operational and business risk. The Group seeks to manage all the risks that arise from its activities and has established a number of committees and policies to do so. Details of these are set out in the Risk Management Report (pages 22 to 58), and the Directors' Report on Corporate Governance (pages 63 to 68).

Employees

The Society recognises that its goal of 'Putting Members First' is best achieved through a knowledgeable, skilled, and motivated workforce.

This underpins all aspects of the Society's approach to its employees. People are recruited on the basis of their behaviours as well as skills and knowledge, and the values of 'Putting Members First' are built in to the way the Society recruits, develops, communicates with and manages its employees.

The Society has invested significantly in developing its employees, and has a framework of training initiatives that provide career advancement and personal development opportunities at all levels of the organisation. It is committed to equal opportunities and encouraging diversity and fostering inclusion, and has policies in place to support the aspirations of applicants and employees, whatever their personal characteristics. Additional support is given to those who need it, for example, if someone has a disability the Society makes appropriate adjustments during the recruitment process so that they have an equal opportunity to perform to the best of their ability. Similarly, if someone becomes disabled during their employment with the Society, it will support them according to their individual needs, which may include retraining and redeployment.

The Society recognises the importance of effective internal communications and operates a number of channels to inform and engage with employees. A well-used intranet and established briefing channels are supported by events and focus groups whilst regular surveys provide additional opportunities to voice opinions and identify areas for improvement. The Society has positive relations with its union, and has worked closely with it on key projects.

For further information see the employees section of the Corporate Responsibility Report on page 20.

Directors' responsibilities in respect of the preparation of the Annual Report & Accounts

The following statement, which should be read in conjunction with the statement of the auditor's responsibilities on pages 94 and 95, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Directors' Remuneration Report, the Annual Business Statement and this Directors' Report.

The Building Societies Act 1986 (the Act) requires the directors to prepare Group and Society Annual Accounts for each financial year. Under that law, they are required to prepare the Group Annual Accounts in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and applicable law and have elected to prepare the Society Accounts on the same basis.

The Group and Society Annual Accounts are required by law and IFRS as adopted by the EU to present fairly the financial position and the performance of the Group and the Society; the Building Societies Act 1986 provides in relation to such Annual Accounts that references in the relevant part of that Act to Annual Accounts giving a true and fair view are references to their achieving a fair presentation. The Act also requires the Annual Accounts to provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made thereunder.

In preparing each of the Group and Society Annual Accounts, the directors are required to:

- Select suitable accounting policies in accordance with IAS 8: *Accounting Polices, Changes in Accounting Estimates and Errors* and apply them consistently.
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- State whether they have been prepared in accordance with IFRS as adopted by the EU.
- Prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Group and Society will continue in business.

In addition to the Annual Accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group.

Directors' responsibilities in respect of accounting records and internal control

The directors are responsible for ensuring that the Group:

- Keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society, in accordance with the Act.
- Takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business (in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000).

The directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors who held office at the date of approval of this Directors' Report confirm that, so far as each of them is aware, there is no relevant audit information of which the Group's auditor is unaware, and each director has taken all the steps that they ought to have taken as directors to make themselves aware of any relevant information and to establish that the Group's auditor is aware of that information.

Directors' statement pursuant to the Disclosure and Transparency Rules

As required by the Disclosure and Transparency Rules of the Financial Conduct Authority, the directors have included a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group. This information is contained principally in the Strategic Report section of the Annual Report & Accounts (pages 2 to 58).

The directors confirm that, to the best of each of their knowledge and belief:

- The financial statements, prepared in accordance with IFRS as adopted by the EU, present fairly the assets, liabilities, financial position and profit of the Group and Society.
- The management report contained in the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Directors' statement pursuant to the UK Corporate Governance Code

As required by the UK Corporate Governance Code, the directors confirm their opinion that the Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members to assess the performance, strategy and business model of the Society.

Details of the governance procedures which have been implemented to support this can be found in the Board Audit Committee report (pages 70 and 71).

Directors' responsibilities in respect of going concern

In preparing the financial statements the directors are required to satisfy themselves that it is reasonable for them to conclude that it is appropriate to adopt the going concern basis in accordance with the Financial Reporting Council's 2014 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' and 'Guidance for Directors of Banks on Solvency and Liquidity Risk Management and the Going Concern Basis of Accounting' and IAS 1 *Presentation of Financial Statements.*

The Society's business activities, together with the factors likely to affect its future development, performance, position, liquidity and capital structure are set out in the Strategic Report section of the Annual Report & Accounts (pages 2 to 58). In addition the Risk Management Report includes further information on the Society's objectives, policies and processes for managing its exposure to credit, market, liquidity and funding, conduct, operational and business risks, along with details of its financial instruments and hedging activities.

The Group's forecasts and projections, taking account of possible changes in trading performance and funding retention, and including stress testing and scenario analysis, show that the Society will be able to operate at adequate levels of both liquidity and capital for at least the next 12 months with no material uncertainties and that all regulatory requests will be met with an appropriate buffer.

After making enquiries, the directors are therefore satisfied that the Society has adequate resources to continue in business for at least the next 12 months with no material uncertainties and therefore it is appropriate to adopt the going concern basis of accounting in preparing these financial statements.

Directors' Report **cont.**

Long term viability statement

In accordance with provision C.2.2 of the 2014 revision of the UK Corporate Governance Code, the directors have assessed the prospects of the Society over a longer period than the 12 months required by the 'going concern' provision considered on page 89.

This information is included on page 58 in the Risk Management Report.

Directors

The directors who served during the year are set out in the Board of Directors section (pages 60 to 62).

The auditor

A resolution to reappoint Ernst & Young LLP as auditor of the Society will be proposed at the Annual General Meeting.

Approved by the Board of directors and signed on its behalf by

Ian Pickering
Chairman
25 February 2016

Welcome to
Financial Statements

In this section you will find our primary financial statements and related notes.

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For our full glossary please go to page 139

What makes us different? Case study

Spending money wisely
The Society's consistently strong financial performance is marked by robust control over costs and risks. This supports the Society in being able to deliver greater value to its saving and borrowing members.

Independent Auditor's Report to the Members of Coventry Building Society

Our opinion on the financial statements

In our opinion:

- the Group's and Society's financial statements (the 'financial statements') give a true and fair view of the state of the Group's and Society's affairs as at 31 December 2015 and of the Group's and Society's profit for the year then ended;
- the Group and Society financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- the financial statements have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the International Accounting Standards (IAS) Regulation.

What we have audited

Coventry Building Society's financial statements comprise:

Group	Society
Consolidated Statement of Financial Position as at 31 December 2015	Statement of Financial Position as at 31 December 2015
Consolidated Income Statement for the year then ended	Income Statement for the year then ended
Consolidated Statement of Comprehensive Income for the year then ended	Statement of Comprehensive Income for the year then ended
Consolidated Statement of Changes in Members' Interests and Equity	Statement of Changes in Members' Interests and Equity
Consolidated Statement of Cash Flows for the year then ended	Statement of Cash Flows for the year then ended
Related notes 1 to 36 to the financial statements	Related notes 1 to 36 to the financial statements

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Overview of our audit approach

Risks of material misstatement	• Revenue recognition and the risk of management override of internal control in relation to Effective Interest Rate (EIR) and fair value adjustments. • Hedge accounting and related fair valuation of financial instruments. • Measurement of loan impairments relating to retail mortgages.
Audit scope	• We performed an audit of the complete financial information of the Group and Society. • Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.
Materiality	• Overall Group materiality of £12.5 million which represents 1% of members' interests and equity (excluding other equity instruments).

Our assessment of risk of material misstatement

We identified the risks of material misstatement described below as those that had the greatest effect on our overall audit strategy, the allocation of resources in the audit and the direction of the efforts of the audit team. In addressing these risks, we have performed the procedures below which were designed in the context of the financial statements as a whole and, consequently, we do not express any opinion on these individual areas.

Risk	Our response to the risk	What we concluded to the Board Audit Committee
Revenue recognition and the risk of management override of internal control in relation to EIR and fair value adjustments		
Interest income on mortgage loans is recognised using EIR method. This is particularly important for mortgages with an initial fixed or discount rate period as IFRS requires that interest income is recognised using a constant yield over the estimated life of the loans. As key judgements such as the expected life of each loan type and future interest rates change, the present value of these changes is recognised in the income statement by the Society. Fair value adjustments, which arose on merger with Stroud & Swindon Building Society, include assumptions on interest rate yields and expected credit losses. The amortisation of these adjustments involves management's judgement about the expected lives of the portfolios and the extent to which actual impairments differ from expected impairment loss assumptions.	We tested internal controls operated by management within the EIR processes, and tested the completeness and accuracy of data on a sample basis from source systems to models. We agreed the model output to the general ledger. We challenged assumptions about the expected lives of loans by comparing them to recent actual redemption behaviour, and compared assumptions about future changes in interest rates to market data and historical experience of mortgage yields. We performed sensitivity analysis over the model to understand the significance of individual assumptions. We recalculated the EIR asset for a sample of loans and agreed the total EIR balance to the general ledger. In relation to merger fair value adjustments, we compared the unamortised expected loss impairment component of fair value adjustments to actual losses incurred. In respect of both EIR and fair value adjustments we challenged assumptions and obtained supporting evidence for adjustments made by management to test the risk of fraud arising from management override of internal controls.	The EIR model inputs and assumptions led to an EIR balance at 31 December which is within an acceptable range. We gained assurance from effective controls operated by management, and the completeness and accuracy of data used within EIR models. We found that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger. Amortisation of merger fair value adjustments remained in line with experience of actual losses incurred by the Society since the time of acquisition. We performed tests for the risk of management override of controls, including testing of journal entries, and found no evidence of such override having occurred.
Hedge accounting and related fair value of financial instruments		
The Group uses fair value and cash flow hedge accounting to manage its interest rate and foreign currency risk. Hedge accounting is complex and therefore inherently more susceptible to error. The valuation of derivatives and any associated hedged items involves subjectivity in terms of valuation methodologies and data inputs used. IAS 39 *Financial Instruments* has specific requirements for the application of hedge accounting and correct identification of sources of ineffectiveness.	We assessed the compliance of hedge accounting documentation with accounting standards. We tested controls over the valuation of hedging instruments, and engaged our in-house derivative valuation specialists to perform independent valuations for a sample of hedge instruments. We tested valuations of hedged items on a sample basis. We tested that sources of ineffectiveness were appropriately identified. We examined the accuracy of the resulting adjustments, including hedge accounting ineffectiveness, and agreed them to the general ledger accounts.	The Society's hedge accounting and related fair valuation of financial instruments has been fairly presented in the 2015 financial statements. We confirmed that the Society's hedge documentation, and the valuation of derivatives and hedged items within designated hedge relationships, meets the requirements of the relevant accounting standards. This resulted in appropriate sources and amounts of hedge ineffectiveness being identified and recorded. We found no significant differences between the Society's hedge accounting records and amounts recorded in the general ledger.
Measurement of loan impairments relating to retail mortgages		
The measurement of loan impairments requires judgement about the probability of default, and the likely loss in the event of default. The loss in event of default depends on the value of the secured property, assumptions on forced sale discounts and the costs to sell.	We tested the accuracy and completeness of data used within the impairment models described in note 1 to the financial statements through reconciliation to source systems and independent testing of internal controls. We recalculated the probability of default derived by roll rates on a sample basis. We challenged management's judgements in key assumptions such as house price movements by comparison to external data sources, and compared forced sale discounts and costs to sell to recent actual experience.	The Society's impairment models and assumptions have led to adequate provisions for incurred losses being recorded as at 31 December. We gained assurance from our testing of the completeness and accuracy of data, and recalculation of roll rates, used within the models. We were satisfied that the Society had applied its impairment policies on a consistent basis with the prior year and that key assumptions determined by management were reasonable and appropriate as at the balance sheet date.

Independent Auditor's Report to the Members of Coventry Building Society **cont.**

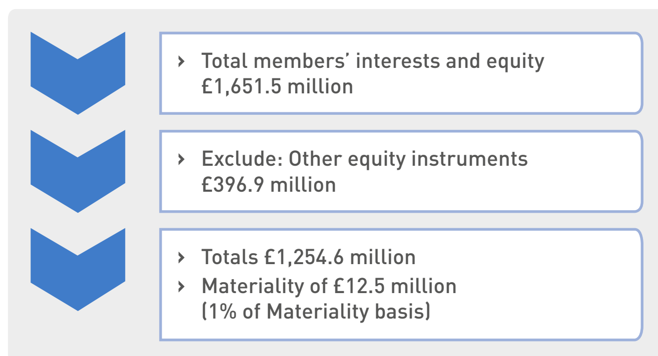
Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £12.5 million (2014: £10.7 million), which is 1% (2014: 1%) of members' interests and equity (excluding other equity instruments). Members' interests and equity is an important overall indicator of the financial strength of the Group and we consider members' interests and equity to be an appropriate basis for materiality given the Group focuses on its mutual status above maximisation of profit generation.



Performance materiality

The application of materiality is at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2014: 50%) of our planning materiality, namely £9.4 million (2014: £5.4 million). We reassessed our performance materiality threshold used in the current year, and based upon our recent experience of auditing the Group, we concluded that there is a lower expectation of undetected misstatement due to the effective control environment and only minor audit differences resulting from our work. As a result, we determined that the higher of our permissible thresholds for our performance materiality was appropriate. We used a proportion of this value for performing the audit work on the subsidiaries based on their individual contribution to the Group as a whole. Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in the financial statements did not exceed our materiality level.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Board Audit Committee that we would report to them all uncorrected audit differences in excess of £0.6 million (2014: £0.5 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies, we consider the implications for our report.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on pages 88 and 89, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (ISAs) (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report is made solely to the Society's members, as a body, in accordance with Section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Matters on which we are required to report by exception

ISAs (UK and Ireland) reporting	We are required to report to you if, in our opinion, financial and non-financial information in the Annual Report is: • materially inconsistent with the information in the audited financial statements; or • apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or • otherwise misleading. In particular, we are required to report whether we have identified any inconsistencies between our knowledge acquired in the course of performing the audit and the directors' statement that they consider the Annual Report & Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for members to assess the entity's performance, business model and strategy; and whether the Annual Report appropriately addresses those matters that we communicated to the Board Audit Committee that we consider should have been disclosed.	We have no exceptions to report.
Building Societies Act 1986	We are required to report to you if, in our opinion: • proper accounting records have not been kept by the Society; or • the Society financial statements are not in agreement with the accounting records; or • we have not received all the information and explanations and access to documents we require for our audit.	We have no exceptions to report.

Statement on the directors' assessment of the principal risks that would threaten the solvency or liquidity of the entity

ISAs (UK and Ireland) reporting	We are required to give a statement as to whether we have anything material to add or to draw attention to in relation to: • the directors' confirmation in the Annual Report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity; • the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated; • the directors' statement in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements; and • the directors' explanation in the Annual Report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.

Steven Robb (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
Leeds
25 February 2016

Income Statements

For the year ended 31 December 2015

	Notes	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Interest receivable and similar income	3	904.0	885.3	795.0	764.3
Interest payable and similar charges	4	(540.1)	(544.0)	(533.1)	(527.5)
Net interest income		363.9	341.3	261.9	236.8
Fees and commissions receivable	5	10.8	11.1	9.1	9.5
Fees and commissions payable	6	(6.6)	(3.3)	(5.4)	(3.2)
Other operating income		1.2	0.4	0.4	0.2
Net (losses)/gains from derivatives and hedge accounting	7	(0.3)	(0.7)	1.8	(3.6)
Total income		369.0	348.8	267.8	239.7
Administrative expenses	8	(124.5)	(112.3)	(116.2)	(105.2)
Amortisation of intangible assets	19	(7.5)	(6.3)	(7.5)	(6.3)
Depreciation of property, plant and equipment	20	(5.4)	(6.0)	(5.3)	(5.9)
Impairment credit/(charge) on loans and advances to customers	10	1.9	(5.4)	1.6	(6.1)
Provisions for liabilities and charges	26	(15.8)	(15.3)	(15.8)	(15.3)
Charitable donation to Poppy Appeal		(1.7)	(1.7)	(1.7)	(1.7)
Profit before tax		216.0	201.8	122.9	99.2
Taxation	11	(44.7)	(43.3)	(25.9)	(21.3)
Profit for the financial year		171.3	158.5	97.0	77.9

Profit for the financial year arises from continuing operations and is attributable to the members of the Society.

Statements of Comprehensive Income

For the year ended 31 December 2015

	Notes	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Profit for the financial year		171.3	158.5	97.0	77.9
Other comprehensive income					
Items that will not be transferred to the Income Statement:					
Remeasurement of defined benefit pension plan	21	11.1	(5.1)	11.1	(5.1)
Taxation	11	(2.2)	1.0	(2.2)	1.0
Effect of change in corporation tax rate	11	0.6	(0.1)	0.6	(0.1)
Items that may be transferred to the Income Statement:					
Available-for-sale investments:					
Fair value movements taken to reserves		(18.4)	81.7	(18.4)	81.7
Amount transferred to Income Statement	30	21.6	(66.8)	21.6	(66.8)
Taxation	11	–	(3.5)	–	(3.5)
Cash flow hedges:					
Fair value movements taken to reserves		(70.8)	(44.0)	(52.2)	(16.0)
Amount transferred to Income Statement		70.4	94.4	48.5	61.0
Taxation	11	0.1	(10.8)	0.8	(9.7)
Effect of change in corporation tax rate	11	(2.7)	0.7	(2.2)	0.6
Other comprehensive income for the year, net of tax		9.7	47.5	7.6	43.1
Total comprehensive income for the year, net of tax		181.0	206.0	104.6	121.0

The notes on pages 100 to 136 form part of these accounts.

Statements of Financial Position

As at 31 December 2015

	Notes	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Assets					
Cash and balances with the Bank of England	12	2,587.8	2,114.5	2,401.0	1,909.0
Loans and advances to credit institutions	13	235.8	180.5	235.8	184.1
Debt securities	14	1,551.7	1,655.2	1,477.7	1,608.2
Loans and advances to customers	15	29,411.0	26,959.6	19,646.3	18,016.0
Hedge accounting adjustment		78.1	98.1	78.1	98.1
Derivative financial instruments	25	173.0	208.3	116.3	135.9
Investment in equity shares	16	3.3	–	3.3	–
Investments in group undertakings	17	–	–	9,645.0	8,884.1
Intangible assets	19	16.3	15.9	16.3	15.9
Property, plant and equipment	20	32.9	28.4	32.9	28.4
Investment properties	20	2.6	5.2	–	0.3
Pension benefit surplus	21	14.2	1.6	14.2	1.6
Deferred tax assets	22	2.0	5.0	–	2.7
Prepayments and accrued income		5.7	6.0	5.5	5.6
Total assets		34,114.4	31,278.3	33,672.4	30,889.9
Liabilities					
Shares		25,355.8	23,395.6	25,355.8	23,395.6
Deposits from banks	23	1,809.9	1,479.0	1,809.9	1,479.0
Other deposits		3.0	7.5	3.0	7.5
Amounts owed to other customers		806.5	452.3	806.5	452.3
Debt securities in issue	24	3,716.6	3,665.5	3,492.5	3,351.2
Hedge accounting adjustment		121.0	162.0	86.7	114.3
Derivative financial instruments	25	353.5	323.3	332.8	321.2
Current tax liabilities		18.3	21.6	9.0	10.7
Deferred tax liabilities	22	10.1	9.1	8.2	8.3
Accruals and deferred income		23.6	26.9	19.1	17.0
Other liabilities		16.0	16.3	125.0	193.4
Provisions for liabilities and charges	26	8.8	8.5	8.8	8.5
Subordinated liabilities	27	58.2	58.2	58.2	58.2
Subscribed capital	28	161.6	161.6	161.6	161.6
Total liabilities		32,462.9	29,787.4	32,277.1	29,578.8
Members' interests and equity					
General reserve		1,222.3	1,061.9	971.6	885.5
Other equity instruments	29	396.9	396.9	396.9	396.9
Available-for-sale reserve	30	2.5	(0.7)	2.5	(0.7)
Cash flow hedge reserve		29.8	32.8	24.3	29.4
Total members' interests and equity		1,651.5	1,490.9	1,395.3	1,311.1
Total members' interests, liabilities and equity		34,114.4	31,278.3	33,672.4	30,889.9

The notes on pages 100 to 136 form part of these accounts.

Approved by the Board of directors on 25 February 2016 and signed on its behalf by

Ian Pickering
Chairman

Mark Parsons
Chief Executive

John Lowe
Finance Director

Statements of Changes in Members' Interests and Equity

For the year ended 31 December 2015

Group	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2015	1,061.9	396.9	(0.7)	32.8	1,490.9
Profit for the financial year	171.3	–	–	–	171.3
Net remeasurement of defined benefit plan	9.5	–	–	–	9.5
Net movement in Available-for-sale reserve	–	–	3.2	–	3.2
Net movement in cash flow hedge reserve	–	–	–	(3.0)	(3.0)
Total comprehensive income	180.8	–	3.2	(3.0)	181.0
Distribution to Additional Tier 1 capital holders*	(20.4)	–	–	–	(20.4)
As at 31 December 2015	1,222.3	396.9	2.5	29.8	1,651.5
As at 1 January 2014	914.6	–	(12.1)	(7.5)	895.0
Profit for the financial year	158.5	–	–	–	158.5
Net remeasurement of defined benefit plan	(4.2)	–	–	–	(4.2)
Net movement in Available-for-sale reserve	–	–	11.4	–	11.4
Net movement in cash flow hedge reserve	–	–	–	40.3	40.3
Total comprehensive income	154.3	–	11.4	40.3	206.0
Issue of Additional Tier 1 capital**	–	396.9	–	–	396.9
Distribution to Additional Tier 1 capital holders*	(7.0)	–	–	–	(7.0)
As at 31 December 2014	1,061.9	396.9	(0.7)	32.8	1,490.9

Society	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2015	885.5	396.9	(0.7)	29.4	1,311.1
Profit for the financial year	97.0	–	–	–	97.0
Net remeasurement of defined benefit plan	9.5	–	–	–	9.5
Net movement in Available-for-sale reserve	–	–	3.2	–	3.2
Net movement in cash flow hedge reserve	–	–	–	(5.1)	(5.1)
Total comprehensive income	106.5	–	3.2	(5.1)	104.6
Distribution to Additional Tier 1 capital holders*	(20.4)	–	–	–	(20.4)
As at 31 December 2015	971.6	396.9	2.5	24.3	1,395.3
As at 1 January 2014	818.8	–	(12.1)	(6.5)	800.2
Profit for the financial year	77.9	–	–	–	77.9
Net remeasurement of defined benefit plan	(4.2)	–	–	–	(4.2)
Net movement in Available-for-sale reserve	–	–	11.4	–	11.4
Net movement in cash flow hedge reserve	–	–	–	35.9	35.9
Total comprehensive income	73.7	–	11.4	35.9	121.0
Issue of Additional Tier 1 capital**	–	396.9	–	–	396.9
Distribution to Additional Tier 1 capital holders*	(7.0)	–	–	–	(7.0)
As at 31 December 2014	885.5	396.9	(0.7)	29.4	1,311.1

* The distribution to Additional Tier 1 capital holders is shown net of an associated tax credit of £5.2 million (2014: £1.9 million).
** The issue of Additional Tier 1 capital is shown net of an associated tax credit of £0.8 million.

The notes on pages 100 to 136 form part of these accounts.

Statements of Cash Flows

For the year ended 31 December 2015

	Notes	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Cash flows from operating activities					
Profit before tax		216.0	201.8	122.9	99.2
Adjustments for:					
Impairment provisions and other provisions	10, 26	13.9	20.7	14.2	20.7
Depreciation and amortisation		12.9	12.3	12.8	12.2
Interest on subordinated liabilities and subscribed capital		16.4	16.4	16.4	16.4
Changes to fair value adjustment of hedged risk		65.7	42.2	41.5	64.1
Other non-cash movements		6.3	33.5	7.4	34.6
Non-cash items included in profit before tax		115.2	125.1	92.3	148.0
Loans to credit institutions		(59.3)	(72.0)	(55.8)	(98.1)
Loans and advances to customers		(2,449.1)	(2,847.3)	(1,628.6)	(1,826.2)
Prepayments, accrued income and other assets		10.0	(6.8)	9.8	(7.1)
Changes in operating assets		(2,498.4)	(2,926.1)	(1,674.6)	(1,931.4)
Shares		1,942.9	2,053.3	1,942.9	2,053.3
Deposits and other borrowings		680.3	565.2	680.3	565.2
Debt securities in issue		(7.3)	(55.9)	(7.6)	(56.5)
Accruals and deferred income and other liabilities		(19.0)	(30.8)	6.4	(0.3)
Changes in operating liabilities		2,596.9	2,531.8	2,622.0	2,561.7
Interest paid on subordinated liabilities and subscribed capital		(16.4)	(16.4)	(16.4)	(16.4)
Taxation		(43.1)	(37.2)	(43.1)	(37.2)
Net cash flows from operating activities		370.2	(121.0)	1,103.1	823.9
Cash flows from investing activities					
Purchase of investment securities		(273.4)	(313.2)	(59.2)	(73.0)
Sale and maturity of investment securities		355.1	405.8	167.9	192.6
Proceeds from sale of properties		3.3	–	0.6	–
Purchase of property, plant and equipment and intangible assets		(20.1)	(16.7)	(20.1)	(16.7)
Net cash flows from investing activities		64.9	75.9	89.2	102.9
Cash flows from financing activities					
Loans to connected undertakings		–	–	(828.8)	(1,105.8)
Issuance of Additional Tier 1 capital		–	396.1	–	396.1
Distribution paid to Additional Tier 1 capital holders		(25.6)	(8.9)	(25.6)	(8.9)
Repurchase and repayment of debt securities		(590.3)	(726.9)	(500.0)	(570.1)
Issue of debt securities		650.0	386.5	650.0	386.5
Net cash flows from financing activities		34.1	46.8	(704.4)	(902.2)
Net increase in cash		469.2	1.7	487.9	24.6
Cash and cash equivalents at start of year		2,073.3	2,071.6	1,867.8	1,843.2
Cash and cash equivalents at end of year		2,542.5	2,073.3	2,355.7	1,867.8
Cash and cash equivalents:					
Cash and balances with central banks	12	2,542.5	2,073.3	2,355.7	1,867.8

The notes on pages 100 to 136 form part of these accounts.

Notes to the accounts

1. Accounting policies

Basis of preparation

These accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union; interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC); and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to organisations reporting under IFRS.

The accounts have been prepared on an historical cost basis, as modified by the revaluation of Available-for-sale debt securities and certain financial instruments which are measured at fair value. As stated in the Directors' Report, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts. A summary of the Group's accounting policies is set out below.

Basis of consolidation

The assets, liabilities and results of the Society and its undertakings, which include subsidiaries and structured entities, are included in the financial statements on the basis of accounts made up to the reporting date.

The Group consolidates another entity from the date on which the Group: (a) has power over the entity; (b) is exposed to, or has the right to, variable returns from its involvement with the entity; and (c) has the ability to affect those returns through the exercise of its powers. The Group reassesses whether it controls an investee if facts and circumstances indicate that there are changes in one or more of the three elements of control. The Group deconsolidates subsidiaries from the date that control ceases.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured vehicles are consolidated when the substance of the relationship indicates control. In making this judgement, the Group considers factors such as the purpose and design of the entity; size and exposure to variability of returns; and the nature of the relationship, including power over the structured entity.

The Society's investment in its subsidiaries is recognised in the Statement of Financial Position at cost less any provision for impairment in value. Upon consolidation, intra-group transactions, balances and unrealised gains are eliminated.

Derecognition of financial assets and liabilities

The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial assets expire or where the Group transfers the financial assets to another party, provided the transfer of the assets also transfers the right to receive the cash flows of the financial assets, and the Group has also transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Group transferring the rights to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised. There was one transaction in the year where financial assets were transferred to a structured entity and were derecognised. For further information see note 18.

The Group derecognises financial liabilities when the obligation is discharged, cancelled or has expired.

Changes in accounting policy

There were no new or amended standards or interpretations that had a significant impact on the preparation of the 2015 financial statements.

Future accounting developments

The following standards, relevant to the Group's future reporting, were not effective as at 31 December 2015 and have therefore not been applied in preparing these financial statements.

Pronouncement	Nature of change	Periods beginning on or after
IFRS 15 *Revenue from Contracts with Customers*	IFRS 15 replaces IAS 18 *Revenue* and provides a new model for revenue recognition. Financial instruments are outside the scope of IFRS 15. The Group is currently assessing the impact IFRS 15 will have on its financial statements. However, given the nature of Group's activities it is not currently anticipated that IFRS 15 will have a significant impact for the Group.	1 January 2018 (subject to EU endorsement)
IFRS 9 *Financial Instruments*	A final version of IFRS 9 was issued in July 2014 to replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 will lead to changes to the classification and measurement of the Group's financial assets and liabilities, in the recognition of impairment, and in relation to hedge accounting. The Group is currently assessing the impact that IFRS 9 will have on its financial statements. Due to the complexity of the new requirements, it is not possible at this stage to quantify the potential effects of implementing IFRS 9 although it is expected to have a significant impact for the Group in line with the wider industry.	1 January 2018 (subject to EU endorsement)
IFRS 16 *Leases*	IFRS 16 was issued in January 2016 and requires operating leases to be capitalised on the Statement of Financial Position as is currently the case for finance leases. The Group is still to assess the impact that IFRS 16 will have on its financial statements.	1 January 2019 (subject to EU endorsement)

Securitisation and covered bond transactions

The Group has securitised certain mortgage loans by the transfer of the loans to structured entities controlled by the Group. The securitisations enable subsequent issuance of debt to investors, who gain the security of the underlying assets as collateral. The structured entities are fully consolidated into the Group accounts.

The transfers of the mortgage loans to the structured entities are not treated as sales by the transferring entity and are not derecognised. The continued recognition of the mortgage loans on the transferor's own Statement of Financial Position is because it retains the risks and rewards of the mortgage loans through the receipt of substantially all of the profits of the structured entities. For securitisations, in the accounts of the Society, the proceeds received from the transfer of mortgage loans are accounted for as a deemed loan repayable to the structured entity disclosed within other liabilities on the Statement of Financial Position.

For covered bonds the position is different, as the Society itself and not the structured entity issues the covered bonds and then lends the proceeds on back to back terms to the covered bond structured entity. Therefore, in the accounts of the Society, the loan to the structured entity and the consideration for the transfer of mortgage loans are not recognised separately as an additional asset and liability. This avoids the 'grossing up' of the financial statements that would otherwise arise.

The Group has also entered into issuances of debt to be used as collateral for central government schemes or for use in sale and repurchase agreements (repos) and similar transactions. Some or all of the issuances of debt may be retained by the Society (self-issued debt). Investments in self-issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows, are not recognised in the Society's financial statements. This avoids the 'grossing up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with the structured entities, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IAS 39, these internal derivatives are treated as part of the deemed loan and not separately measured at fair value because the relevant mortgage loans are not derecognised. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives relating to securitisations are treated as explained in the derivatives and hedging accounting policy (see pages 105 and 106).

Notes to the accounts **cont.**

1. Accounting policies continued

Funding for Lending Scheme

The Society participates in the Funding for Lending Scheme (FLS), which provides Treasury bills in return for eligible collateral including approved mortgage portfolios, self-issued covered bonds and self-issued Residential Mortgage Backed Securities (RMBS). FLS transactions do not involve the transfer of risk on the collateral and hence fail the derecognition criteria under IAS 39. Therefore, for accounting purposes, the underlying collateral is retained on the Statement of Financial Position and the Treasury bills are not separately recognised.

Interest receivable and interest payable

For instruments measured at amortised cost the Effective Interest Rate (EIR) method is used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The EIR is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

In calculating the EIR, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees received and paid and costs borne that are an integral part of the EIR and all other premiums above or below market rates.

Interest income on Available-for-sale debt securities is included in interest receivable and similar income.

Fees and commissions

Fees and commissions receivable and payable that are not spread across expected asset lives under the EIR method are taken to income on an accruals basis as services are provided, or on the completion of an act to which the fee relates.

Taxation including deferred tax

Corporation tax on the profits for the year comprises current and deferred taxation.

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the Statement of Financial Position date.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred tax assets and liabilities are measured on a non-discounted basis at the tax rates that are expected to apply when the related asset is realised or liability settled based on the tax rates and laws enacted or substantively enacted at the Statement of Financial Position date. Deferred tax assets and liabilities are offset when there is both a legally enforceable right and intention to settle on a net basis.

Corporation tax is charged or credited directly to the Statement of Other Comprehensive Income if it relates to items that are credited or charged to the Statement of Other Comprehensive Income, and to the Statements of Changes in Members' Interests and Equity if it relates to other equity instruments. Otherwise corporation tax is recognised in the Income Statement.

Segmental reporting

The Group operates solely within the retail financial services sector and within the United Kingdom. As such, no segmental analysis is required.

Financial assets

The Group classifies its financial assets at inception into the following categories:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's residential mortgage loans, unsecured lending and loans to credit institutions are classified as loans and receivables.

Loans are recognised when the funds are advanced to customers. Loans and receivables are carried at amortised cost using the EIR method less provisions for impairment.

Loans and receivables acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the opening amortised cost for acquired loans and receivables. Fair value adjustments are made to reflect both credit risk and interest yield associated with the acquired loan assets. Any discount between book value and the fair value is recognised in interest receivable and similar income using the EIR method, except for any specific credit impairment provisions which are either utilised against non-performing assets or released to interest receivable and similar income if assumptions around the future asset performance are revised.

For a portfolio acquisition the fair value is normally assumed to be the transaction price (i.e. the consideration paid). However, the fair value may differ from the transaction price in certain circumstances. Where the valuation technique is based on observable market data only, the gain or loss arising from the difference between the fair value and the transaction price is recognised immediately. In circumstances where other inputs are required in the valuation of the portfolio, any gain or loss arising from the difference between the fair value and the transaction price is recognised over an appropriate period of time.

Fair value through profit or loss

All derivatives are carried at fair value and are initially recognised at the trade date.

For those derivatives in fair value hedge accounting relationships and for any derivatives not in a hedge accounting relationship, gains and losses arising from changes in the fair values are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy note (pages 105 and 106).

For derivatives in cash flow hedge accounting relationships, the gains and losses arising from changes in fair value are initially recognised in the Statement of Other Comprehensive Income as set out in the hedge accounting policy note for cash flow hedges (pages 105 and 106).

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are designated as such or not classified into either of the two categories above. Available-for-sale assets comprise debt securities (e.g. certificates of deposit or gilts) and investment in equity shares.

Available-for-sale assets are measured at fair value. The fair values of debt securities, in the majority of cases, are based on quoted market prices or prices obtained from market intermediaries. In cases where quoted market prices are not available, discounted cash flow valuations are used.

Investments in equity shares that do not have a quoted market price in an active market and whose value cannot be reliably measured are recognised at cost. This has been the case in respect of the Group's investment in Visa Europe Limited in prior years. Due to the proposed acquisition of Visa Europe by Visa Inc., a fair value has been determined as at 31 December 2015 (see note 16).

Unrealised gains and losses arising from changes in fair value are recognised directly in the Available-for-sale reserve, except for impairment losses and foreign exchange gains and losses, which are recognised in the Income Statement. Gains and losses arising on the sale of Available-for-sale assets, including any cumulative gains or losses previously recognised in the Available-for-sale reserve, are recognised in the Income Statement.

1. Accounting policies continued

When a decline in the fair value of an Available-for-sale financial asset has been recognised directly in the Available-for-sale reserve and there is objective evidence that the asset is impaired, the cumulative loss recognised in the Available-for-sale reserve is removed and recognised in the Income Statement.

Impairment of loans and advances to customers

The Group assesses its loans and advances to customers for objective evidence of impairment at each Statement of Financial Position date. An impairment loss is recognised if, and only if, there is a loss event (or events) that has occurred after initial recognition and before the Statement of Financial Position date and has a reliably measurable impact on the estimated future cash flows.

Impairment is categorised as either individual impairment (where individual assets have been assessed for loss) or collective impairment (where losses are assessed as being present in a portfolio of loans, but they cannot be attributed to individual accounts). As well as loans that are individually or collectively identified as being impaired, recognition is also made of accounts where forbearance has been exercised and agreement has been reached with customers in financial difficulty to temporarily forgo some element of the payment due or where other impairment indicators are present.

If there is objective evidence that an impairment loss on loans and advances to customers has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred).

Estimating future cash flows

Future cash flows are based upon prudent assumptions about the value of the property representing the underlying security for the mortgage, workout costs that might be incurred in realising the value of the property (i.e. following repossession and sale), the likelihood of repossession and the time it takes to repossess and sell properties.

- All properties being used as security are valued at the outset of the loan and, if a further advance is made during the lifetime of the loan, at the time of the further advance.
- Once the value of the property has been established, the Nationwide Regional House Price Index is used to provide an updated estimate of the property's value, on a quarterly basis.
- Assumptions are continuously updated to reflect the time taken to sell a repossessed property and the likely discount to the latest property valuation. Typically, the forced sale discount averages 28% of the property value.
- No assumptions are made as to the future value of properties beyond the estimation of a discount for the forced sale that results from a repossession of a mortgaged property.

Individual assessment of impairment

The identification of loans for individual assessment of impairment is via a set days-past-due trigger being met or if, in the opinion of management, there is evidence that individually identifiable loans are impaired even if a set days-past-due trigger has not yet been met. For example, a small number of customers have been declared bankrupt but continue to make their mortgage repayments as scheduled. These customers can be individually identified and therefore an individual assessment can be made as to the level of potential impairment.

The Group employs various models to assess the level of impairment. These include models to predict roll rates to default, the likelihood of possession given default, shortfalls in property values over loan balances after accounting for expected costs, the effects of forced sale, and updated valuations including via house price indexation. The assumptions in these models capture the differing experience of different mortgage types, and are updated regularly to reflect ongoing experience, with overlays to ensure appropriate judgement is reflected in the final assessment of impairment.

Collective assessment of impairment

A variety of collective impairment assessments have been made against segments of the mortgage book where there is objective evidence of an impairment event impacting that segment, but which cannot be individually attributed, or more generally where there is evidence of an increased risk of credit losses being present but, again, where the risks cannot be individually attributed. Examples of segments where collective assessments of impairment have been conducted

include provisions held to collectively address the risk that in a downturn, issues will emerge that will adversely affect the value and saleability of properties, something that would otherwise be masked in a growing housing market.

Forbearance impairment assessment

Assessment has also been made of customers who are undergoing some measure of forbearance. Evidence-based results are used to identify potential forbearance indicators, measure the performance of accounts with these indicators and determine the level of impairment provision required.

Use of overlays

Management applies overlays to assumptions to ensure that an appropriate level of conservatism in cash flow forecasts is employed. For instance, current point-in-time experience may be for an improvement in a particular roll rate, but if the longer-term view is that the risk remains higher than the short-term backwards looking experience used in the model, an overlay may be applied to reflect forward looking judgement of cash flows. An example is in values applied in the 'probability of possession from default' assumption. The applied probabilities of possession are generally more conservative than the current short-term experience to accommodate the fact that the likelihood of possession may increase in the event of a further economic downturn.

Recognition of post-impairment improvement

Impairment provisions are raised as the risk is recognised and measured. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, an appropriate amount of the previously recognised impairment loss is reversed by adjusting the impairment provision. The amount of the reversal is recognised in the Income Statement.

Write-off policy and recognition of post-loss recoveries

When a loan is not collectable, it is written off against the related provision for loan impairment (see note 10). Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recorded in the Income Statement.

Sale and repurchase agreements

Securities sold subject to a commitment to repurchase them are retained on the Statement of Financial Position when substantially all the risks and rewards of ownership remain within the Group. The counterparty liability is included separately on the Statement of Financial Position, as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements using the EIR method.

Derivative financial instruments

The Group holds derivative financial instruments to manage the risks associated with its various fixed and capped rate assets, its fixed rate liabilities and its foreign currency transactions. In accordance with legislation and its treasury policy, the Group holds derivative financial instruments only for risk management and not for speculative or trading purposes.

All derivative financial instruments are carried at fair value. Derivatives are principally valued by discounting cash flows using yield curves that are based on observable market data. For collateralised positions the Group uses discount curves based on overnight indexed swap (OIS) rates and for non-collateralised positions the Group uses discount curves based on term LIBOR rates. In measuring fair value, separate adjustments are made for credit risk to the extent not already included in the valuation.

Hedge accounting

All derivatives entered into by the Group are for the purpose of providing an economic hedge. Where the criteria set out in IAS 39 are met, the Group uses hedge accounting and designates the hedging derivative as either hedging fair value or cash flow risks.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement under net (losses)/gains from derivatives and hedge accounting in the period in which the movement occurs together with the change in fair value of the hedged asset or liability that is attributable to the hedged risk (interest rate risk). This also applies if the hedged item is classified as an Available-for-sale financial asset.

1. Accounting policies continued

Cash flow hedges

Changes in the effective part of any gain or loss on the derivative financial instrument hedging the variability in cash flows of a recognised asset or liability are recognised directly through the Statement of Other Comprehensive Income in the cash flow hedge reserve. In the periods in which the hedged item affects profit or loss, these changes in value are reclassified to the Income Statement in the line item affected by the hedged item. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. The hedged risks for cash flow hedges are interest rate risk and currency risk (euro to sterling).

Leases and contract purchase agreements

Where the Group enters into a lease that entails taking substantially all the risks and rewards of ownership of an asset, the agreement is treated as a finance lease. The asset is recorded on the Statement of Financial Position within property, plant and equipment and is depreciated over its estimated useful life. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the lease term and its useful life. Future instalments under such leases, net of finance charges, are included within other liabilities. Rentals payable are apportioned between the finance element, which is charged to the Income Statement at a constant annual rate, and the capital element, which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and payments are charged to administrative expenses on a straight line basis over the period of the lease. Rents receivable are credited to other operating income on a straight line basis over the period of the lease.

Intangible assets

Software development costs and purchased software that is not an integral part of a related hardware purchase are recognised as an intangible asset. Amortisation of such assets is charged to the Income Statement on a straight line basis over the useful life of the asset. The useful life of computer software is estimated to be between three and eight years.

Investment properties and property, plant and equipment

Investment property is property held to earn rentals or for capital appreciation or for both, rather than for sale or use in the business. The Group recognises investment properties at cost less accumulated depreciation and any accumulated impairment. The carrying values of investment properties are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment. The carrying values of property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

An asset's carrying value is written down immediately to its recoverable amount if the asset's carrying value is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying value of the asset and are included within the Income Statement.

Depreciation is provided on a straight line basis over the anticipated useful life of the asset as follows:

Freehold buildings (including investment properties)	Over a period of 50 years
Leasehold buildings	Shorter of remaining term of the lease and useful life
Equipment, fixtures, fittings and vehicles	Three to eight years

Employee benefits

Pensions

The Group operates a defined benefit pension scheme and a defined contribution scheme for employees.

Contributions to the defined contribution pension scheme are recognised as an expense in the Income Statement as incurred, on an accruals basis.

The Group's net obligation under the defined benefit pension scheme is assessed annually by an independent qualified actuary. The net obligation is calculated as the difference between the fair value of the scheme's assets and the amount of future entitlements earned by scheme members from service in the current and prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds. This calculation allows the net obligation of the scheme to be expressed as either a surplus or deficit, which is recognised as either an asset or a liability respectively in the Group's accounts at the Statement of Financial Position date.

Gains or losses arising from the remeasurement of the defined benefit plan are recognised in full, in the year they occur, in the Statement of Comprehensive Income.

Other long-term employee benefits

The cost of bonuses payable 12 months or more after the end of the financial year in which they are earned is recognised in the year in which the employees render the related service and when there is an obligation to pay a bonus under the terms of the scheme.

Short-term employee benefits

The cost of short-term employee benefits, including wages and salaries, social security costs, bonuses payable within 12 months and healthcare, is recognised in the year of service.

Financial liabilities

Financial liabilities incorporate shares, bank and other deposits, amounts owed to other customers, debt securities in issue, derivative financial liabilities, subordinated liabilities and subscribed capital. The Group classifies its financial liabilities into the following categories:

Amortised cost

Financial liabilities (other than derivatives) are measured on an amortised cost basis. This represents the face value adjusted for any unamortised premiums, discounts and transaction costs directly attributable to the acquisition or issue. The amortisation is recognised in interest payable and similar charges using the EIR method.

Fair value through profit or loss

All derivatives are carried at fair value.

Gains and losses arising from changes in the fair values are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy note (see pages 105 and 106).

For derivatives in cash flow hedge accounting relationships, the gains and losses arising from changes in fair value are initially recognised in the Statement of Other Comprehensive Income as set out in the hedge accounting policy note for cash flow hedges (see pages 105 and 106).

Provisions and contingent liabilities

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and the amount can be estimated reliably. For the Financial Services Compensation Scheme (FSCS) Levy, a provision is recognised when the levy is legally enforceable, in accordance with IFRIC 21 *Levies*.

Contingent liabilities are potential obligations from past events which shall be confirmed by future events. Contingent liabilities are not recognised within the Statement of Financial Position unless arising from a business combination.

1. Accounting policies continued

Equity instruments

Issued financial instruments are classified as equity instruments where the contractual arrangements with the holder do not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments. Where the Group does have a present obligation the instrument is classified as a financial liability.

The proceeds of the issuance of equity instruments are included in equity. Costs incurred that are incremental and directly attributable to the issuance are deducted from the proceeds (net of applicable tax) and are not amortised.

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted, net of tax where applicable, from the general reserve.

During 2014 the Group issued a new type of equity instrument. Further information is included in note 29.

Foreign currency translation

The consolidated financial statements are presented in pounds sterling, which is the functional currency of the Group.

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the Statement of Financial Position date. Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the Income Statement.

Cash and cash equivalents

For the purposes of the statements of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks and loans and advances to credit institutions.

IFRS disclosure

For ease of reference, certain audited IFRS disclosures are included within the Risk Management Report as follows:

- Credit risk (pages 30 to 39).
- Market risk (pages 39 to 42).
- Liquidity and funding risk (pages 42 to 48).

A maturity analysis for all assets and liabilities is presented in a table, on pages 44 and 45.
Audited information is also included within the Directors' Remuneration Report on pages 81 to 86.

These disclosures, where marked as 'audited', are covered by the Independent Auditor's Report on pages 92 to 95.

2. Judgement in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgement and estimates are disclosed are in the following notes:

Area of significant judgement and estimate	Note
Mortgage EIR	3
Fair value adjustments in respect of acquired assets	3
Impairment provisions on loans and advances to customers	10
Valuation of Level 3 derivatives	33

3. Interest receivable and similar income

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
On loans fully secured on residential property	944.5	909.0	560.1	543.5
On other loans				
Connected undertakings	–	–	277.2	246.4
Other	2.5	2.7	1.7	1.9
	947.0	911.7	839.0	791.8
Interest and other income on debt securities	37.7	40.5	37.5	39.7
Interest and other income on other liquid assets	9.7	10.9	8.9	10.6
Net expense on financial instruments hedging assets	(90.4)	(77.8)	(90.4)	(77.8)
Total	904.0	885.3	795.0	764.3

Included within interest receivable and similar income is interest accrued of £3.4 million (2014: £5.3 million) for the Group and £2.1 million (2014: £3.3 million) for the Society on impaired loans and advances to customers.

Critical accounting estimates and judgements

The Group recognises interest on loans and advances to customers on the basis of their EIR. This is a constant rate that averages out the effect of incentives and fees across the expected life of the loan account. A critical assumption in the calculation is the expected life, as this determines the assumed period over which customers may be paying various differentiated interest rates. The calculation of the EIR uses assumptions on expected life that are based on the experience of similar products. These assumptions are monitored to ensure their ongoing appropriateness. Changes in the amortised cost balance arising from actual product life experience, differing from the assumed life, are periodically calculated and an adjustment made to the loan balance, with a corresponding adjustment to interest receivable and similar income. A decrease in the average expected life of a loan after the initial incentive period of one month would result in a decrease in loans and advances to customers of £9.0 million, with a corresponding reduction to income in the Income Statement. Assumptions as to future market interest rates also affect the calculation. A relative increase in market rates of five basis points per annum over five years would result in a decrease in loans and advances to customers of £11.6 million with a corresponding reduction to income in the Income Statement.

Where assets are acquired as a result of merger or via the purchase of mortgage portfolios, the Society is required to estimate the expected life and associated cash flows of the assets and amortise the fair value adjustments over this period. Similarly, the Society is required to estimate a suitable period to amortise the impact of any transactions where the transaction price differed from fair value. If different assumptions were made then the impact of these adjustments would be recognised over longer or shorter periods. The impact of increasing the length of these assumptions by one year would have reduced profits by £2.6 million.

4. Interest payable and similar charges

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Bank and customer				
Subordinated liabilities	4.2	4.2	4.2	4.2
Other	20.5	14.7	20.5	14.7
Debt securities in issue	115.9	136.8	87.4	97.6
Other borrowed funds				
On shares held by individuals	453.8	437.8	453.9	437.8
On other shares	0.1	0.1	0.1	0.1
On subscribed capital	12.2	12.2	12.2	12.2
On loans from connected undertakings	–	–	3.9	5.4
Net income on financial instruments hedging liabilities	(66.6)	(61.8)	(49.1)	(44.5)
Total	540.1	544.0	533.1	527.5

Notes to the accounts **cont.**

5. Fees and commissions receivable

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Mortgage related fees	4.8	4.7	3.1	3.1
General insurance commissions	4.2	4.6	4.2	4.6
Other fees and commissions	1.8	1.8	1.8	1.8
Total	10.8	11.1	9.1	9.5

6. Fees and commissions payable

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Banking fees	2.3	2.2	2.3	2.1
Other fees and commissions	4.3	1.1	3.1	1.1
Total	6.6	3.3	5.4	3.2

7. Net (losses)/gains from derivatives and hedge accounting

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
(Losses)/gains on derivatives designated as fair value hedges	(1.2)	(101.6)	12.2	(112.4)
Movement in fair value of hedged items attributable to hedged risk	(1.4)	100.1	(14.8)	109.6
	(2.6)	(1.5)	(2.6)	(2.8)
Derivatives designated as cash flow hedges*	2.3	0.8	1.9	0.6
Gains/(losses) on other derivatives	–	–	2.5	(1.4)
Total	(0.3)	(0.7)	1.8	(3.6)

* Represents ineffectiveness on cash flow hedge relationships which will mature over a period of six years.

8. Administrative expenses

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Employee costs				
Wages and salaries	61.6	57.8	61.6	57.8
Social security costs	6.1	5.6	6.1	5.6
Pension costs				
Defined benefit plan (note 21)	(0.1)	(0.2)	(0.1)	(0.2)
Defined contribution plan	4.4	4.0	4.4	4.0
	72.0	67.2	72.0	67.2
Other expenses				
Loss on disposal of property, plant and equipment and intangibles	0.8	1.6	0.8	1.6
Premises and facilities	11.2	10.5	11.2	10.5
Information systems and project costs	14.2	7.1	14.2	7.1
Other	26.3	25.9	18.0	18.8
Total	124.5	112.3	116.2	105.2

The remuneration of the auditor, Ernst & Young LLP, is set out below:

Group and Society	2015 £m	2014 £m
Audit of the annual accounts	0.2	0.2
Audit related assurance services – subsidiary audits	0.1	0.1
Other assurance services	–	0.1
Total	0.3	0.4

The Group's policy in relation to the use of its auditors on non-audit engagements sets out the nature of services they are generally precluded from performing. Further details on the Society's policy is included within the Board Audit Committee Report on page 72. All non-audit engagements provided by the Group's auditor are subject to pre-approval by either the Board Audit Committee or the Finance Director (on a limited delegated basis from the Board Audit Committee), depending upon the nature of the non-audit engagement.

9. Employee numbers

Group and Society	2015 Full time	2015 Part time	2014 Full time	2014 Part time
The average number of persons employed during the year (including executive directors) was:				
Head office and administrative centres	1,189	324	1,131	302
Branches	356	277	371	261
Total	1,545	601	1,502	563

The average number of employees on a full time equivalent basis was 1,916 (2014: 1,850) and all of these are employed within the United Kingdom.

10. Impairment provisions on loans and advances to customers

Impairment provisions have been deducted from the appropriate asset values on the Statement of Financial Position. The incurred loss element of the fair value adjustments arising from the merger with Stroud & Swindon Building Society in 2010 of £4.3 million (2014: £5.2 million) has been included within the opening and closing provisions in the tables below.

Group	Loans fully secured on residential property 2015 £m	Other loans 2015 £m	Total 2015 £m	Loans fully secured on residential property 2014 £m	Other loans 2014 £m	Total 2014 £m
At 1 January						
Individual impairment	11.7	4.4	16.1	16.2	1.3	17.5
Collective impairment	9.2	0.8	10.0	9.1	0.8	9.9
	20.9	5.2	26.1	25.3	2.1	27.4
(Credit)/charge for the year						
Individual impairment	(0.3)	0.1	(0.2)	1.7	3.6	5.3
Collective impairment	(1.8)	0.1	(1.7)	0.1	–	0.1
	(2.1)	0.2	(1.9)	1.8	3.6	5.4
(Credit)/charge set against fair value adjustment	(0.4)	–	(0.4)	(0.4)	(0.2)	(0.6)
Amounts written off	(1.9)	(0.2)	(2.1)	(5.8)	(0.3)	(6.1)
At 31 December						
Individual impairment	9.4	4.3	13.7	11.7	4.4	16.1
Collective impairment	7.1	0.9	8.0	9.2	0.8	10.0
Total	16.5	5.2	21.7	20.9	5.2	26.1

Notes to the accounts **cont.**

10. Impairment provisions on loans and advances to customers continued

Society	Loans fully secured on residential property 2015 £m	Other loans 2015 £m	Total 2015 £m	Loans fully secured on residential property 2014 £m	Other loans 2014 £m	Total 2014 £m
At 1 January						
Individual impairment	6.6	3.9	10.5	9.2	0.5	9.7
Collective impairment	3.9	0.2	4.1	3.4	0.2	3.6
	10.5	4.1	14.6	12.6	0.7	13.3
(Credit)/charge for the year						
Individual impairment	(0.6)	(0.1)	(0.7)	1.4	3.5	4.9
Collective impairment	(1.0)	0.1	(0.9)	0.5	–	0.5
	(1.6)	–	(1.6)	1.9	3.5	5.4
(Credit)/charge set against fair value adjustment	(0.1)	–	(0.1)	0.1	–	0.1
Amounts written off	(1.1)	–	(1.1)	(4.1)	(0.1)	(4.2)
At 31 December						
Individual impairment	4.8	3.8	8.6	6.6	3.9	10.5
Collective impairment	2.9	0.3	3.2	3.9	0.2	4.1
Total	7.7	4.1	11.8	10.5	4.1	14.6

When arriving at the impairment provision, the Group has considered accounts with forbearance and other potential impairment indicators. See pages 35 and 36 for further details.

Critical accounting estimates and judgements

In accordance with the accounting policy described in note 1, impairment is measured as the difference between an asset's carrying amount and the present value of management's estimate of discounted future cash flows. Key assumptions include the probability of any account going into default, the probability of defaulting accounts progressing to possession and the eventual loss incurred in the event of forced sale or write-off. These assumptions are based on observable historical data and updated as management considers appropriate to reflect current conditions.

If average regional house prices were to fall by 10%, the estimated impact on the impairment provision would be an increase of £1.4 million. If the probability of defaulting accounts progressing to possession decreased by 5% the estimated impact on the impairment provision would be a decrease of £0.4 million.

11. Taxation

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Current tax				
UK corporation tax at 20.25% (2014: 21.5%)	44.1	42.6	25.4	20.8
UK corporation tax – adjustment in respect of prior years	1.1	(0.2)	1.1	(0.2)
Total current tax	45.2	42.4	26.5	20.6
Deferred tax				
Current year	0.3	0.9	0.2	0.7
Adjustment in respect of prior years	(0.8)	–	(0.8)	–
Total deferred tax	(0.5)	0.9	(0.6)	0.7
Total	44.7	43.3	25.9	21.3

The effective tax rate for the year is 20.7% (2014: 21.5%) for the Group and 21.1% (2014: 21.5%) for the Society. A reconciliation between tax expense and the accounting profit multiplied by the UK standard corporation tax rate of 20.25% (2014: 21.5%) is as follows:

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Profit before tax (PBT)	216.0	201.8	122.9	99.2
Tax at UK standard rate of corporation tax on PBT of 20.25% (2014: 21.5%)	43.7	43.4	24.9	21.3
Adjustments in respect of prior years	0.3	(0.2)	0.3	(0.2)
Utilisation of capital losses for which credit not previously recognised	(0.1)	–	(0.1)	–
Effect of rate change	0.4	–	0.4	–
Expenses not deductible for tax purposes	0.4	0.1	0.4	0.2
Total	44.7	43.3	25.9	21.3

The tax on items reported through the Statements of Comprehensive Income is as follows:

Statement of Comprehensive Income	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Tax charge/(credit) on remeasurement of defined benefit pension plan	2.2	(1.0)	2.2	(1.0)
Tax charge on Available-for-sale movements	0.9	3.5	0.9	3.5
Recognition of capital losses for which credit not previously recognised	(0.9)	–	(0.9)	–
Tax (credit)/charge on cash flow hedges	(0.1)	10.8	(0.8)	9.7
Effect of change in corporation tax rate	2.1	(0.6)	1.6	(0.5)
Total	4.2	12.7	3.0	11.7

The tax on other items reported through the Statements of Changes in Members' Interests and Equity is as follows:

Statement of Changes in Members' Interests and Equity	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Tax credit on issuance costs of Additional Tier 1 capital	–	(0.8)	–	(0.8)
Tax credit on Additional Tier 1 capital distribution	(5.2)	(1.9)	(5.2)	(1.9)
Total	(5.2)	(2.7)	(5.2)	(2.7)

Further information relating to deferred tax is presented in note 22.

12. Cash and balances with the Bank of England

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Cash and balances with the Bank of England other than mandatory reserve deposits	2,542.5	2,073.3	2,355.7	1,867.8
Mandatory reserve with the Bank of England	45.3	41.2	45.3	41.2
Total	2,587.8	2,114.5	2,401.0	1,909.0

The £2,343.6 million (2014: £1,871.2 million) cash and balances with the Bank of England included in the Group liquidity resources table on page 42 excludes the £45.3 million (2014: £41.2 million) mandatory reserve with the Bank of England and £198.9 million (2014: £202.1 million) of cash held in accounts other than with the Bank of England (predominantly in the Group's covered bond and RMBS programmes).

Notes to the accounts **cont.**

13. Loans and advances to credit institutions

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Loans and advances to credit institutions have remaining maturities as follows:				
Accrued interest	0.1	–	0.1	–
Repayable on demand	235.7	180.5	235.7	184.1
Total	235.8	180.5	235.8	184.1

The Group liquidity resources table on page 42 excludes the above £235.8 million (2014: £180.5 million) held in collateral accounts with counterparties relating to interest rate swap agreements and sale and repurchase transactions.

14. Debt securities

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Available-for-sale:				
UK Government investment securities	1,432.8	1,433.5	1,358.8	1,386.5
Other listed transferable debt securities	118.9	221.7	118.9	221.7
Total	1,551.7	1,655.2	1,477.7	1,608.2
Movements during the year are analysed below:				
At 1 January	1,655.2	1,666.0	1,608.2	1,646.0
Additions	273.4	313.2	59.2	73.0
Maturities and disposals	(355.1)	(405.8)	(167.9)	(192.6)
Changes in fair value	(21.8)	81.8	(21.8)	81.8
At 31 December	1,551.7	1,655.2	1,477.7	1,608.2

A maturity analysis of the Group debt securities is included in a table on pages 44 and 45. The Society's debt securities are not materially different.

Pledged assets (Encumbrance) – Sale and repurchase transactions of debt securities

As part of its liquidity management, the Group enters into sale and repurchase agreements, whereby the Group sells but agrees to repurchase assets at a future date. UK Government investment securities have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership. The Group is unable to use, sell or pledge the transferred assets for the duration of the transaction and remains exposed to any associated interest rate risk and credit risk of the assets. Proceeds of these sale and repurchase agreements are included within deposits from banks (see note 23).

	Pledged 2015 £m	Proceeds 2015 £m	Pledged 2014 £m	Proceeds 2014 £m
Available-for-sale:				
UK Government investment securities	850.1	851.1	712.7	708.3

The £627.6 million (2014: £895.5 million) of on-balance sheet debt securities included in the Group liquidity resources table on page 42 excludes £850.1 million (2014: £712.7 million) of pledged assets and £74.0 million (2014: £47.0 million) held by the Group's covered bond and RMBS programmes as neither of these is available for use in the Group's day-to-day activities.

Although not included on the Statement of Financial Position, the Group has received FLS Treasury bills with a market value of £2,045.5 million (2014: £1,322.6 million). Subsequently, Treasury bills with a market value of £903.3 million (2014: £706.3 million) were pledged as part of sale and repurchase agreements for proceeds of £899.2 million (2014: £700.4 million) included in deposits from banks (see note 23).

Again, although not included on the Statement of Financial Position, the Group has received UK Government investment securities with a market value of £24.2 million (2014: £38.9 million) pledged by counterparties under interest rate swap agreements (see note 34).

15. Loans and advances to customers

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Residential				
Owner-occupier mortgages	18,395.4	16,826.2	17,726.2	16,065.0
Buy to let mortgages	10,588.2	9,647.9	1,739.3	1,745.4
Near-prime mortgages	94.6	104.1	6.2	6.6
Self-certification mortgages	289.9	330.3	148.0	167.6
Other				
Commercial mortgages	3.8	5.5	0.7	1.1
Unsecured personal loans	39.1	45.6	25.9	30.3
Total	29,411.0	26,959.6	19,646.3	18,016.0

Maturity analysis

The remaining maturity of loans and advances to customers at the Statement of Financial Position date is as follows:

	Note	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
In not more than one year		2,294.2	2,122.8	1,485.8	1,398.6
In more than one year		27,138.5	24,862.9	18,172.3	16,632.0
		29,432.7	26,985.7	19,658.1	18,030.6
Impairment provision	10	(21.7)	(26.1)	(11.8)	(14.6)
Total		29,411.0	26,959.6	19,646.3	18,016.0

The maturity analysis is based on contractual maturity, not actual redemption levels experienced by the Group or Society.

Pledged assets – Loans and advances to customers

Certain loans and advances to customers have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools with the Bank of England. The programmes have enabled the Group to obtain secured funding.

Loans and advances to customers pledged to support the programmes and the FLS, and the notes in issue are as follows:

2015	Mortgages pledged £m	Notes in issue: Held by third parties £m	Notes in issue: Held by the Group drawn £m	Notes in issue: Held by the Group undrawn £m	Notes in issue: Total £m
Loans and advances to customers					
Covered bond programme	4,461.7	1,787.4	1,400.0	–	3,187.4
Securitisation programme – Leofric No.1 plc	424.4	224.1	–	37.5	261.6
Securitisation programme – Mercia No.1 plc	1,526.1	–	1,271.5	164.9	1,436.4
Whole mortgage loan pools	3,385.7	–	–	3,385.7	3,385.7
Total	9,797.9	2,011.5	2,671.5	3,588.1	8,271.1

Notes to the accounts **cont.**

15. Loans and advances to customers continued

2014	Mortgages pledged £m	Notes in issue: Held by third parties £m	Notes in issue: Held by the Group drawn £m	Notes in issue: Held by the Group undrawn £m	Notes in issue: Total £m
Loans and advances to customers					
Covered bond programme	4,359.7	1,660.6	1,400.0	–	3,060.6
Securitisation programme – Leofric No.1 plc	527.1	314.3	–	52.5	366.8
Securitisation programme – Mercia No.1 plc	1,539.1	–	308.1	1,128.3	1,436.4
Whole mortgage loan pools	3,142.5	–	–	3,142.5	3,142.5
Total	9,568.4	1,974.9	1,708.1	4,323.3	8,006.3

Mortgages pledged are not derecognised from the Group or Society Statements of Financial Position as the Group has retained substantially all the risk and rewards of ownership. No gain or loss has been recognised on pledging the mortgages to the programmes.

The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under the FLS, subject to a 'haircut' as defined by the Bank of England. Therefore, balances shown in the table on page 115 under notes in issue are the outstanding balances of the mortgages.

Notes in issue and held by third parties are included within debt securities in issue (note 24).

Notes in issue, held by the Group and drawn include debt securities issued by the covered bond programme to the Society and those issued by the Mercia securitisation programme, pledged as collateral.

Notes in issue, held by the Group and undrawn are other debt securities issued by the programmes to the Society, and mortgage loan pools that have been pre-positioned at the Bank of England but not utilised. These are held to provide collateral for potential future use in sale and repurchase agreements or central bank operations.

Notes in issue, and held by the Group are not recognised on the Group or Society Statements of Financial Position, thus preventing inappropriate grossing up of the Group and Society Statements of Financial Position.

Covered bonds

The Group established Coventry Building Society Covered Bonds LLP (LLP) in July 2008, initially in order to provide security for issues of self-issued covered bonds and subsequently for external issuances. As at 31 December 2015, the Society had in issue £2,800.0 million (2014: £2,650.0 million) and €500.0 million (2014: €500.0 million) of covered bonds; of which £1,400.0 million (2014: £1,400.0 million) was retained by the Group.

At the reporting date, the Society has overcollateralised the LLP as set out in the table on page 115 to secure the ratings of the covered bonds and to provide operational flexibility. From time to time, the obligation of the Society to provide collateral may increase due to the formal requirements of the programme and the value of the collateral would depend upon conditions at that time. The Society may also voluntarily contribute collateral to support the covered bond ratings.

During 2014, the Society provided non-contractual capital contributions totalling £271.0 million to the LLP as a result of a regulatory requirement to pre-fund upcoming contractual covered bond redemptions. No such contribution was made in 2015. During the period, the Society also voluntarily repurchased £244.4 million (2014: £643.2 million) of mortgages from the LLP to maintain the quality of the pool and minimise the overcollateralisation requirement.

Securitisation – Leofric No.1 plc

Leofric No.1 plc (Leofric) was incorporated in November 2011. In May 2012, Leofric issued £933.5 million of listed debt securities secured against certain loans of the Society and its subsidiary Godiva Mortgages Limited, of which £133.5 million was retained by the Group. Under the terms of the securitisation programme, the nominal amount of the debt securities is paid down to match the payment profile of the mortgages pledged to the programme. As at 31 December 2015, the nominal value of listed debt securities in issue had fallen to £261.6 million, of which £37.5 million was held by the Group. The Group's obligations in respect of the Leofric securitisation vehicle are limited to transferring cash flows from the underlying assets.

Securitisation – Mercia No.1 plc

Mercia No.1 plc (Mercia) was incorporated in October 2012 and in December 2012 Mercia issued £1,436.4 million of listed debt securities, all of which were retained by the Group. As at 31 December 2015, listed debt securities totalled £1,436.4 million. The Group's obligations in respect of the Mercia securitisation vehicle are limited to transferring cash flows from the underlying assets.

The fair value of assets that have been pledged and their associated liabilities where recourse is limited to the underlying asset are presented in the table below:

	Fair value assets pledged 2015 £m	Fair value liabilities 2015 £m	Fair value net position 2015 £m	Fair value assets pledged 2014 £m	Fair value liabilities 2014 £m	Fair value net position 2014 £m
Securitisation programme – Leofric No.1 plc	424.4	264.4	160.0	527.1	371.4	155.7

The above table excludes the Mercia securitisation programme as all the notes issued were retained by the Society.

16. Investments in equity shares

The investment in equity shares is in respect of Visa Europe Limited (VE).

On 2 November 2015, Visa Inc. announced the proposed acquisition of VE to create a single global payments business under the VISA brand. The Society is a member and shareholder of VE and in exchange for its single €10 ordinary share will receive upfront consideration in the form of cash (approximately €4.5 million) and Visa Inc. preference shares (at 31 October 2015 valued by Visa Inc. at approximately €3.1 million). The preference shares are convertible into Class A common shares of Visa Inc. at a future date subject to conditions including that the conversion rate may be reduced to cover certain litigation costs (primarily the setting of interchange rates). In addition, the Group may receive deferred cash consideration in 2020 which is contingent on certain performance thresholds being met.

In accordance with its Available-for-sale accounting policy, the Society previously recognised its investment in the VE share at cost as it did not have a quoted market price in an active market, and they could not otherwise be reliably measured. At 31 December 2015, the share has been recognised at the sterling equivalent (£3.3 million) of the €4.5 million upfront cash consideration. As the preference shares and deferred cash consideration components cannot currently be reliably measured, these elements have been valued at nil.

On completion of the transaction, the Society expects to recognise a gain in the Income Statement based on the upfront proceeds and a fair value amount in relation to the preference shares and deferred cash consideration at that time. The fair value amount will need to reflect a number of factors and uncertainties relating to these elements. Subject to regulatory approval, completion is currently expected to occur in the first half of 2016.

Notes to the accounts cont.

17. Investments in subsidiary undertakings and consolidated structured entities

Society	Shares £m	Loans £m	Total 2015 £m
At 1 January	8.0	8,876.1	8,884.1
Additions	–	760.9	760.9
At 31 December	8.0	9,637.0	9,645.0

The Society has the following consolidated subsidiary undertakings, all of which are registered in England, operate in the United Kingdom and are wholly owned by Coventry Building Society:

Subsidiary undertakings	Principal activity
Godiva Mortgages Limited	Mortgage lending
ITL Mortgages Limited	Mortgage lending and mortgage acquisition vehicle
Five Valleys Property Company Limited	Investment properties holding company
Coventry Financial Services Limited	Non-trading
Coventry Property Services Limited	Non-trading
Godiva Financial Services Limited	Non-trading
Godiva Housing Developments Limited	Non-trading
Godiva Savings Limited	Non-trading
Godiva Securities and Investments Limited	Non-trading

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control in accordance with the accounting policy set out in note 1. The following structured entities are consolidated:

Subsidiary undertakings	Principal activity
Coventry Building Society Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds
Leofric No.1 plc	Funding vehicle
Mercia No.1 plc	Funding vehicle

The nature and risks associated with the Society's investments in these entities (including obligations of financial support) are disclosed in note 15.

18. Interest in unconsolidated structured entity

The Group completed a whole loan sale of its beneficial interests in £310.0 million of buy to let mortgages originated by its subsidiary Godiva Mortgages Limited (Godiva) to a third party in the final quarter of the year. The profit on sale is included in interest receivable and similar income in the Income Statement. The Society continues to service the loan book.

These assets were initially assessed for derecognition under IAS 39 and a subsequent assessment was made as to whether there was any requirement to consolidate the results of the third party who purchased the loan book under IFRS 10 *Consolidated Financial Statements*.

Derecognition

To derecognise the loan book, the Group has to transfer its rights to receive the cash flows from the assets and also to have transferred substantially all risks and rewards associated with the assets.

Although Godiva continues to receive the contractual cash flows from the mortgages it has an obligation to pay these cash flows to the third party by the next business day.

With regard to risks and rewards, the beneficial interests in the mortgages were sold for cash and neither Godiva nor the Society has any interest in the third party. Godiva will retain any fees relating to further advances on the mortgages but the income is expected to be de minimis. Any loan repurchase commitments relate to further advances and product switches only, and would only arise as a result of a breach of representations and warranties which are limited to 12 months, or as a result of non-permitted product transfers. Any repurchase commitments are also expected to be de minimis.

Taking all of the facts and circumstances into account, the Group has transferred substantially all the risk and rewards of ownership and it is therefore appropriate to derecognise the assets.

Consolidation of the results of the structured entity

The Group consolidates another entity from the date on which the Group: has power over the entity; is exposed to, or has rights to, variable returns from its involvement with the entity; and has the ability to affect those returns through the exercise of its power.

Under the Mortgage Sale Agreement and the Service Agreement, Godiva retains the right to set lending criteria in relation to further advances on the transferred mortgages; to set policies and subsequently amend mortgages in line with these policies; and to set the Standard Variable Rate (SVR). However, in exercising these powers the Group is not exposed to any variable return and therefore does not benefit from the exercise of its discretionary powers. The Society is in receipt of a service provider fee but this is set on an arms-length basis and on market standard terms. The fee of £0.1 million is included within fee and commission income in the Income Statement.

The Group has therefore concluded that it is acting as agent for the beneficial holders of the loan book and not as a principal acting in its own interests. The purchasing entity is therefore not consolidated in the Group results.

19. Intangible assets

Group and Society	2015 £m	2014 £m
Cost		
At 1 January	28.0	18.1
Additions	9.5	11.3
Retirements	(5.6)	(1.4)
At 31 December	31.9	28.0
Amortisation		
At 1 January	12.1	5.9
Charge for the year	7.5	6.3
Amortisation on retirements	(4.0)	(0.1)
At 31 December	15.6	12.1
Net book value at 31 December	16.3	15.9

Intangible assets consist entirely of software development costs and purchased software that is not an integral part of a related hardware purchase.

Notes to the accounts **cont.**

20. Property, plant and equipment

Group and Society	Land and buildings Freehold £m	Land and buildings Long leasehold £m	Land and buildings Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost					
At 1 January 2015	9.3	3.8	3.4	36.5	53.0
Additions	–	2.3	–	8.3	10.6
Disposals	–	–	–	(5.7)	(5.7)
At 31 December 2015	9.3	6.1	3.4	39.1	57.9
Depreciation					
At 1 January 2015	1.7	0.6	2.3	20.0	24.6
Charge for the year	0.1	0.2	–	5.0	5.3
Depreciation on disposals	–	–	–	(4.9)	(4.9)
At 31 December 2015	1.8	0.8	2.3	20.1	25.0
Net book value at 31 December 2015	7.5	5.3	1.1	19.0	32.9

Group and Society	Land and buildings Freehold £m	Land and buildings Long leasehold £m	Land and buildings Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost					
At 1 January 2014	9.3	3.9	3.4	50.5	67.1
Additions	–	0.1	–	5.3	5.4
Disposals	–	(0.2)	–	(19.3)	(19.5)
At 31 December 2014	9.3	3.8	3.4	36.5	53.0
Depreciation					
At 1 January 2014	1.5	0.7	2.3	33.2	37.7
Charge for the year	0.2	0.1	–	5.6	5.9
Depreciation on disposals	–	(0.2)	–	(18.8)	(19.0)
At 31 December 2014	1.7	0.6	2.3	20.0	24.6
Net book value at 31 December 2014	7.6	3.2	1.1	16.5	28.4

Disposals relate to assets that were retired during the year.

Equipment, fixtures, fittings and vehicles includes assets held under finance leases as follows:

Group and Society	2015 £m	2014 £m
Net book value	2.1	1.7
Accumulated depreciation	0.9	0.9

The net book value of land and buildings occupied by the Group for its own activities is as follows:

Group and Society	2015 £m	2014 £m
At 31 December	13.7	11.8

Investment properties

Group	2015 £m	2014 £m
Cost		
At 1 January	5.6	5.6
Additions	–	–
Disposals	(2.8)	–
At 31 December	2.8	5.6
Depreciation		
At 1 January	0.4	0.3
Charge for the year	0.1	0.1
Depreciation on disposals	(0.3)	–
At 31 December	0.2	0.4
Net book value at 31 December	2.6	5.2

The fair value of the properties held by the Group as at 31 December 2015 was £3.6 million (2014: £6.3 million).

21. Pension scheme

The Society operates a funded defined benefit and a defined contribution pension scheme.

The Coventry defined benefit pension scheme (the Fund) is administered by a separate trust that is legally separated from the Society. The Fund has been closed to new members since December 2001 and provides benefits based on final pensionable salary but was closed to future service accrual from 31 December 2012. The trustees of the Fund are required to act in the best interest of the plan's beneficiaries. The appointment of the trustees is determined by the plan's trust documentation. It is policy that one third of all trustees should be nominated by the members of the pension fund. As at 31 December 2014, the date of the last full actuarial valuation, 1,834 current employees, former employees and former executive directors were members of the Fund.

The Fund is subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, set out the framework for funding defined benefit occupational pension plans in the UK.

The Fund typically exposes the Society to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to plan liabilities. This would detrimentally impact the Statement of Financial Position and may give rise to increased charges in future periods. This effect would be partially offset by an increase in the value of the plan's bond and liability matching holdings. Additionally, caps on inflationary increases are in place to protect the plan against extreme inflation.

The pension scheme assets are invested in Liability Matching Funds (LMFs). These are leveraged pooled funds that are used to help manage interest rate and inflation risk. The investment policy of the LMFs can be summarised as follows:

- Each LMF relates to a single named benchmark gilt – the Fund holds units in the 2022, 2027, 2032, 2040, 2050 and 2062 index-linked gilt LMFs.
- The LMFs will principally hold a combination of gilt sale and repurchase agreements (repos), gilt total return swaps and physical gilts.
- The leverage of each fund will vary with changes in interest rates and inflation. The Fund Manager will follow a recapitalisation process if the leverage in any individual LMF reaches a heightened level and follow a re-leveraging process if the leverage in any individual LMF decreases to a depressed level.
- The Fund Manager aims to limit the exposure to each counterparty to 30% of each LMF's overall exposure.
- The Fund will retain the coupon payments and will use them for leverage management rather than being re-invested in the benchmark gilt. Full proceeds will be distributed upon maturity of the benchmark gilt.

Notes to the accounts **cont.**

21. Pension scheme continued

For the purposes of IAS 19 *Employee Benefits (Revised)* the actuarial valuation as at 31 December 2014, which was carried out by a qualified independent actuary, has been updated on an approximate basis to 31 December 2015. There have been no changes in the valuation methodology adopted for this period's disclosures compared with the previous period's disclosures.

IAS 19 allows the Society to recognise a surplus as an asset, reflecting the Society's ability to recover a surplus either through reduced contributions in the future or through refunds from the Fund after the last benefit has been paid.

The cost of the Fund was assessed in accordance with the advice of a qualified actuary on the basis of valuations using the projected unit method. The main assumptions used in the valuations were:

i. An investment return pre-retirement of 1.75% (2014: 1.6%) per annum in excess of projected pre-retirement benefit increase.
ii. An investment return post-retirement of 0.85% (2014: 0.7%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued prior to 6 April 2006 and 1.75% (2014: 1.3%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued after 6 April 2006.

A full actuarial valuation was carried out as at 31 December 2014 in accordance with the scheme funding requirements of the Pensions Act 2004 and the funding of the scheme is agreed between the Society and the trustees in line with those requirements. This actuarial valuation showed a deficit of £11.5 million. The Society agreed with the trustees that it would aim to eliminate the deficit by 30 September 2019 by the payment of annual contributions of £1.4 million.

During 2012 the decision was taken to close the pension scheme to future service accrual. Consequently there were no contributions in respect of members' pensionable salaries during 2015 (2014: nil); however the Society contributed £1.4 million in line with the deficit recovery plan. The best estimate of contributions to be paid by the Society to the plan in 2016 is £1.4 million. The Society continues to meet the expenses of the plan and levies to the Pension Protection Fund.

The present value of plan liabilities is measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit credit method. The value calculated in this way is then deducted from the fair value of plan assets and the net surplus is presented on the Statement of Financial Position as shown below:

Group and Society	2015 £m	2014 £m
Present value of funded obligation	(169.1)	(184.5)
Fair value of plan assets	183.3	186.1
Funded status/Pension benefit surplus	**14.2**	1.6

	2015			2014		
	Present value of obligation £m	Fair value of plan assets £m	Total £m	Present value of obligation £m	Fair value of plan assets £m	Total £m
As at 1 January	(184.5)	186.1	1.6	(157.7)	162.8	5.1
Included within administrative expenses:						
Interest (expense)/income	(6.6)	6.7	0.1	(7.1)	7.3	0.2
Included within other comprehensive income:						
Remeasurements:						
Return on plan assets (excluding amounts in the Income Statement)	–	(6.4)	(6.4)	–	19.5	19.5
Gains/(losses) from changes in financial assumptions	17.5	–	17.5	(24.6)	–	(24.6)
	17.5	(6.4)	11.1	(24.6)	19.5	(5.1)
Other contributions and payments:						
Employer contributions	–	1.4	1.4	–	1.4	1.4
Benefit payments	4.5	(4.5)	–	4.9	(4.9)	–
	4.5	(3.1)	1.4	4.9	(3.5)	1.4
As at 31 December	(169.1)	183.3	14.2	(184.5)	186.1	1.6

The major categories of plan assets are:

	Plan assets at 31.12.2015 £m	Plan assets at 31.12.2014 £m
Quoted		
Corporate bonds and liability matching	114.7	118.0
Diversified growth funds	27.0	28.1
Cash	1.5	1.9
Unquoted		
Corporate bonds and liability matching	22.0	23.0
Property	18.1	15.1
Total	183.3	186.1

The principal actuarial assumptions used are as follows:

Weighted average assumptions used to determine benefit obligation at	31.12.2015 %	31.12.2014 %
Discount rate	3.85	3.60
Rate of pensionable salary increase	–	2.00
Rates of inflation (Retail Prices Index)	3.10	3.00
Rates of inflation (Consumer Price Index)	2.10	2.00

Weighted average assumptions used to determine net pension cost for the year ended	31.12.2015 %	31.12.2014 %
Discount rate	3.60	4.55
Rate of pensionable salary increase	–	2.40
Rates of inflation (Retail Prices Index)	3.00	3.40
Rates of inflation (Consumer Price Index)	2.00	2.40

Weighted average life expectancy for mortality tables used to determine benefit obligation at	31.12.2015		31.12.2014	
	Male	Female	Male	Female
Member age 60 (current life expectancy)	26.8	28.9	26.9	29.3
Member age 45 (life expectancy at age 60)	28.1	30.4	28.9	31.3

The assumptions on mortality are determined by the actuarial tables known as S2PXA with CMI 2015 projections with a 1.25% per annum long-term improvement rate (2014: S1PXA with CMI 2013 projections with a 1.25% per annum long-term improvement rate).

The Group has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension fund surplus and changes in these assumptions could affect the reported surplus. The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is:

Impact on present value of obligation:	Change in assumption	Increase in assumption %	Decrease in assumption %
Discount rate	0.25%	(4.7)	4.8
Rates of inflation (Retail Prices Index and Consumer Price Index)	0.25%	4.0	(3.9)
Life expectancy	1 year	2.5	(2.6)

The average duration of the defined benefit obligation at the period ending 31 December 2015 was 22 years.

Notes to the accounts **cont.**

22. Deferred tax

Deferred tax assets and liabilities are attributable to the following items:

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Deferred tax assets				
Provisions	–	0.3	–	0.3
IFRS transitional fair value adjustments	–	0.3	–	0.2
Excess of depreciation over capital allowances	–	2.0	–	2.0
Transfer of engagements – fair value adjustments	2.0	2.4	–	0.2
Total	2.0	5.0	–	2.7
Deferred tax liabilities				
Cash flow hedges	10.0	8.2	7.9	7.4
Defined benefit pension plan surplus	3.6	0.3	3.6	0.3
Transfer of engagements – fair value adjustments	0.2	0.3	0.2	0.3
Investment in equity shares	0.9	–	0.9	–
Excess of depreciation over capital allowances	(3.2)	–	(3.1)	–
Provisions	(0.4)	–	(0.4)	–
IFRS transitional fair value adjustments	(0.1)	0.3	–	0.3
Capital losses	(0.9)	–	(0.9)	–
Total*	10.1	9.1	8.2	8.3

* In 2015, the deferred tax assets and liabilities have been netted to the full extent possible on the face of the Statement of Financial position as there is both the legal right and a stated intention to settle on a net basis. In 2014, although there was a legal right to settle net there was no stated intention to do so and therefore there was no netting of the deferred tax assets and liabilities.

The Group recognises deferred tax on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available to utilise the asset.

The Group considers that sufficient future taxable trading profits will be available to utilise the Group's trading deferred tax assets and the Group has therefore recognised such deferred tax assets where they have arisen.

In respect of carried forward capital losses the Group and Society have recognised a deferred tax asset of £0.9 million (2014: £nil), where it is expected that the losses will be offset against future capital gains. This leaves the Group with carried forward capital losses, where no deferred tax asset has been recognised, of £1.5 million (2014: £4.9 million), and the Society with £1.2 million (2014: £4.9 million). These losses are available for offset against future chargeable gains and under current tax legislation do not time expire.

The headline rate of UK corporation tax reduced from 21% to 20% on 1 April 2015. The Finance (No. 2) Act 2015, enacted on 18 November 2015, introduced two further 1% reductions to the headline rate of corporation tax to 19% from 1 April 2017 and 18% from 1 April 2020. The Finance (No. 2) Act 2015 also introduced a surcharge of 8% to be applied to the profits of banking companies from 1 January 2016.

Under IAS 12 *Income Taxes* deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on the tax rates and tax laws that have been enacted or substantively enacted by the Statement of Financial Position date.

Accordingly, with the future reduction of the corporation tax rate to 19% and 18% and the introduction of the 8% surcharge, the deferred tax balances at 31 December 2015 have been reflected at the tax rates at which they are expected to be realised or settled.

23. Deposits from banks

A maturity analysis for the Group's deposits from banks is included in a table on pages 44 and 45. The Group and Society balances are identical.

As at 31 December 2015, deposits from banks include £1,750.3 million (2014: £1,408.7 million) in respect of sale and repurchase agreements, of which £899.2 million (2014: £700.4 million) relates to off-balance sheet Treasury bills. The carrying value of assets of £850.1 million (2014: £712.7 million) sold under sale and repurchase agreements is included within debt securities (see note 14). The Group held £nil (2014: £1.9 million) of collateral deposited by counterparties under sale and repurchase agreements.

As at 31 December 2015, £nil (2014: £1.1 million) was held by the Group as amounts deposited by counterparties under interest rate swap collateralisation agreements.

24. Debt securities in issue

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Certificates of deposit	87.7	3.0	87.7	3.0
Medium-term notes	1,617.4	1,687.6	1,617.4	1,687.6
Covered bonds	1,787.4	1,660.6	1,787.4	1,660.6
Residential Mortgage Backed Securities (Leofric)	224.1	314.3	–	–
Total	3,716.6	3,665.5	3,492.5	3,351.2

Debt securities in issue are repayable from the Statement of Financial Position date in the ordinary course of business as follows:

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Accrued interest	38.4	39.7	37.9	39.0
Other debt securities in issue with residual maturity repayable:				
In not more than one year	90.1	522.9	90.1	522.9
In more than one year	3,588.1	3,102.9	3,364.5	2,789.3
Total	3,716.6	3,665.5	3,492.5	3,351.2

In March 2015, the Society issued a £500.0 million five year floating rate covered bond, which replaced a maturing bond, and later in the year raised an additional £150.0 million from the same issuance.

25. Derivative financial instruments

Derivative financial instruments are held for risk mitigation purposes and are designated as hedging derivatives under the terms of IAS 39. The tables below analyse derivatives between those designated as hedging instruments and those which, whilst in economic hedging relationships, are not designated as hedging instruments. Contractual/notional amounts indicate the amount on which payments flows are derived at the Statement of Financial Position date and do not represent amounts at risk.

Foreign exchange gains of £72.6 million have been recognised in the Income Statement relating to the principal amount of financial instruments held at amortised cost. This is offset by £72.6 million of foreign exchange losses on derivative financial instruments held at fair value.

	2015			2014		
Group	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate swaps	20,593.4	173.0	262.6	16,144.8	208.3	302.1
Derivatives designated as cash flow hedges:						
Cross currency swaps*	1,340.4	–	90.9	1,340.4	–	21.2
Total derivatives	21,933.8	173.0	353.5	17,485.2	208.3	323.3
Derivatives have remaining maturities as follows:						
In not more than one year	5,715.0	9.0	13.2	4,359.0	2.6	2.2
In more than one year	16,218.8	164.0	340.3	13,126.2	205.7	321.1
Total derivatives	21,933.8	173.0	353.5	17,485.2	208.3	323.3

	2015			2014		
Society	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate swaps	19,843.4	113.8	262.6	15,394.8	135.9	302.1
Derivatives designated as cash flow hedges:						
Cross currency swaps*	946.1	–	70.2	946.1	–	18.0
Other derivatives:						
Interest rate basis swaps	650.0	2.5	–	500.0	–	1.1
Total derivatives	21,439.5	116.3	332.8	16,840.9	135.9	321.2
Derivatives have remaining maturities as follows:						
In not more than one year	5,715.0	9.0	13.2	4,859.0	2.6	3.3
In more than one year	15,724.5	107.3	319.6	11,981.9	133.3	317.9
Total derivatives	21,439.5	116.3	332.8	16,840.9	135.9	321.2

* Cash flows are expected to occur over a six year period (2014: seven) in respect of both Group and Society cross currency swaps.

For valuing collateralised derivatives the Group uses discount curves based on OIS rates, whilst for non-collateralised derivatives discount curves based on term LIBOR rates are used.

In addition to the above, the Society also has intra-Group interest rate swaps with the subsidiaries that operate the Group's covered bond and RMBS programmes. Under these agreements, the Society receives the interest income of the subsidiaries' mortgage books and pays LIBOR on the same basis as the subsidiaries' interest expense. These swaps have a nominal principal amount of £4,839.3 million (2014: £4,984.8 million) and are accounted for on an accruals basis in accordance with IAS 39; see note 1 for further details.

26. Provisions for liabilities and charges

Group and Society	FSCS 2015 £m	Other provisions 2015 £m	Total 2015 £m	FSCS 2014 £m	Other provisions 2014 £m	Total 2014 £m
At 1 January	7.8	0.7	8.5	8.7	1.2	9.9
Charge for the year	14.1	1.7	15.8	15.3	–	15.3
Provisions utilised	(14.9)	(0.6)	(15.5)	(16.2)	(0.5)	(16.7)
At 31 December	7.0	1.8	8.8	7.8	0.7	8.5

FSCS levy provision

All deposit-taking institutions that are members of the UK Financial Services Compensation Scheme (FSCS) are required to contribute to the costs of the FSCS in safeguarding the deposits of savers in financial institutions. The Society is, and continues to be, a member of the FSCS. Contributions to the FSCS are calculated according to a prescribed formula using the retail savings balances of all deposit-taking institutions who are members of the FSCS. As at 31 December 2015, the Group held a provision of £7.0 million with respect to the estimated FSCS levy for the period 2015/16. The FSCS provision is expected to be utilised in September 2016.

Other provisions

Other provisions have also been recognised in respect of circumstances that may give rise to various customer claims including Payment Protection Insurance (PPI) redress. The charge in the year reflects a small increase in the amount settled per case, and the impact of the introduction of a deadline for PPI claims.

The Group has no contingent liabilities to report.

27. Subordinated liabilities

Group and Society	2015 £m	2014 £m
Subordinated liabilities owed to note holders are as follows:		
Fixed rate subordinated notes 2016 – 12.25%	7.1	7.1
Fixed rate subordinated notes 2021 – 6.12%	10.1	10.1
Fixed rate subordinated notes 2022 – 6.469%	15.5	15.5
Fixed rate subordinated notes 2026 – 6.327%	10.2	10.2
Fixed rate subordinated notes 2032 – 7.54%	15.3	15.3
Total	58.2	58.2

All the subordinated liabilities are denominated in sterling. The notes are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, with the prior consent of the Prudential Regulation Authority (PRA).

The subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members, other than holders of Permanent Interest Bearing Shares (PIBS) and Perpetual Capital Securities (PCS), as to principal and interest.

In January 2016 the Society, with the consent of the PRA, repurchased all £15.5 million of the Fixed rate subordinated notes 2022 – 6.469%.

Notes to the accounts **cont.**

28. Subscribed capital

Group and Society	Call date	2015 £m	2014 £m
Subscribed capital owed to permanent interest holding members is as follows:			
Permanent Interest Bearing Shares 1992 – 12 1/8%	n/a	41.5	41.5
Permanent Interest Bearing Shares 2006 – 6.092%	June 2016	120.1	120.1
Total		161.6	161.6

Interest is paid in arrears on £40.0 million PIBS at the rate of 12 1/8% per annum in half yearly instalments, and on £120.0 million PIBS at the rate of 6.092% per annum in half yearly instalments.

PIBS rank equally with each other and PCS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than holders of PCS) as to principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

The PIBS issued in 1992 are only repayable in the event of the winding up of the Society. The 2006 PIBS are repayable in the event of a winding up of the Society or otherwise, with the prior consent of the PRA, at the option of the Society in whole but not in part on the 29 June 2016 call date or quarterly thereafter. If not repaid on the call date, then the interest rate is reset at a rate equal to 3 month LIBOR plus 2.19%.

29. Other equity instruments

In June 2014, the Society issued £400.0 million of new PCS capital (£396.9 million net of issuance costs and associated tax). These instruments rank equally with each other and PIBS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than PIBS) as to principal and interest. The holders of PCS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

The PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.375% per annum. The rate will reset on 1 November 2019 and every five years thereafter to the five year mid swap rate plus 4.113%. Coupons are paid semi-annually in May and November.

Coupon payments of £12.8 million, covering the period 1 November 2014 to 30 April 2015, and £12.8 million, covering the period 1 May 2015 to 31 October 2015, were approved and have been recognised (net of tax) in the Statement of Change in Members' Interests and Equity. A coupon payment of £8.9 million, covering the period from issuance to 31 October 2014, was made and recognised in the financial year ended 31 December 2014.

The instruments have no maturity date. They are repayable at the option of the Society in 2019 and on every fifth anniversary thereafter, but only with the prior consent of the PRA. If the end-point Common Equity Tier 1 ratio for the Group, on either an individual consolidated or a consolidated basis, falls below 7% they convert to Core Capital Deferred Shares (CCDS) at the rate of one CCDS for every £67 held.

The returns paid to investors on these securities are treated as an appropriation of profit after tax, reflecting their categorisation as equity instruments, and hence are not reflected within the Income Statement, but instead are distributed directly from the general reserve.

30. Available-for-sale reserve

Amounts within the Available-for-sale reserve are transferred to the Income Statement upon the disposal of debt securities, and where a fair value hedging relationship exists between the debt securities and a derivative instrument.

During the year a £21.6 million gain (2014: £66.9 million loss) was transferred to net (losses)/gains from derivatives and hedge accounting in the Income Statement with respect to hedge accounting adjustments relating to Available-for-sale debt securities in fair value hedge accounting relationships. Amounts transferred to interest receivable and similar income totalled £nil (2014: £0.1 million loss) in respect of the disposal of Available-for-sale debt securities.

31. Financial commitments

Subject to the satisfaction of previously agreed loan to value ratios, the Group and Society are committed to the following undrawn mortgage loan facilities relating to equity release and flexible mortgage products:

	Group 2015 £m	Group 2014 £m	Society 2015 £m	Society 2014 £m
Undrawn mortgage loan facilities	74.7	86.7	59.5	68.1

In addition, the Group has also agreed but not contractually committed to advance £1,609.5 million (2014: £1,353.1 million) in respect of loans and advances to customers.

32. Capital and leasing commitments

Capital commitments

Group and Society	2015 £m	2014 £m
Capital expenditure contracted for but not provided for in the accounts	0.9	0.2

Leasing commitments

Future minimum lease payments under non-cancellable operating leases relating to land and buildings were as follows:

Group and Society	2015 £m	2014 £m
Amounts falling due:		
Within one year	3.2	2.8
Between one and five years	10.0	7.7
After five years	7.4	5.7
Total	20.6	16.2
Lease payments recognised as an expense in the period	4.3	3.7

Leasing payments due as lessor

As at 31 December 2015, the Group and Society had future minimum lease payments receivable under non-cancellable subleases of £0.1 million due within one year (2014: £0.1 million). It had £nil of payments due between one and five years (2014: £0.1 million).

The Group and Society had future minimum lease payments receivable under non-cancellable leases of £nil due within one year (2014: £0.1 million).

33. Financial instruments – classification and fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted prices (unadjusted) in active markets for identical instruments.
- Level 2: valuation techniques for which all significant inputs are based on observable market data.
- Level 3: valuation techniques for which significant inputs are not based on observable market data.

33. Financial instruments – classification and fair value measurement continued

Where applicable, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. For all other financial instruments the Group determines fair values using other valuation techniques.

The following table summarises the fair value of the Group's financial assets and liabilities measured at amortised cost on the face of the Group's Statement of Financial Position and the disaggregation by the fair value hierarchy.

The Society position is not materially different to that of the Group except for £9,764.7 million (2014: £8,943.6 million) of loans and advances to customers with a fair value of £9,767.9 million (2014: £8,937.4 million) which are held in subsidiaries of the Society.

2015 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	235.8	–	235.8	–	235.8
Loans and advances to customers	29,411.0	–	–	29,327.1	29,327.1
Financial liabilities					
Shares	25,355.8	–	–	25,597.2	25,597.2
Deposits from banks	1,809.9	–	1,809.4	–	1,809.4
Other deposits	3.0	–	3.0	–	3.0
Amounts owed to other customers	806.5	–	806.4	–	806.4
Debt securities in issue	3,716.6	3,865.7	88.1	–	3,953.8
Subordinated liabilities	58.2	–	63.8	–	63.8
Subscribed capital	161.6	199.2	–	–	199.2

2014 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	180.5	–	180.5	–	180.5
Loans and advances to customers	26,959.6	–	–	26,884.6	26,884.6
Financial liabilities					
Shares	23,395.6	–	–	23,673.1	23,673.1
Deposits from banks	1,479.0	–	1,477.5	–	1,477.5
Other deposits	7.5	–	7.5	–	7.5
Amounts owed to other customers	452.3	–	452.3	–	452.3
Debt securities in issue	3,665.5	3,957.5	19.1	–	3,976.6
Subordinated liabilities	58.2	–	63.5	–	63.5
Subscribed capital	161.6	201.0	–	–	201.0

Loans and advances to customers

The fair value of loans and advances to customers is assessed as the value of the expected future cash flows. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Conservative assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting estimated future cash flows are discounted at current market rates to determine a fair value. These fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

Customer shares and deposits

Shares and deposits from customers are valued in accordance with the cash flows projected from the contractual terms of the deposits. The fair value of shares and deposits that are available on demand approximates to the carrying value.

The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows from those deposits discounted at the current market rates for those types of deposit.

Debt securities in issue, subordinated liabilities and subscribed capital

The estimated fair value of longer-dated liabilities are calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of significant size or liquidity to have an active market quote. For those liabilities where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate to the remaining term to maturity.

The following table summarises the fair value of the Group's financial assets and liabilities measured at fair value on the face of the Group's Statement of Financial Position and the disaggregation by fair value hierarchy and product type.

The Society position is not materially different to that of the Group except for £59.2 million (2014: £72.5 million) of interest rate swap assets and £20.7 million (2014: £3.2 million) of cross currency swap liabilities, which are held in subsidiaries of the Society, and a £2.5 million fair value asset (2014: £1.1 million fair value liability) relating to intercompany interest rate basis swaps that would only be disclosed in the Society.

2015 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	173.0	–	173.0
Total	–	173.0	–	173.0
Debt securities				
UK Government investment securities	1,432.8	–	–	1,432.8
Other listed transferable debt securities	102.2	9.7	7.0	118.9
Total	1,535.0	9.7	7.0	1,551.7
Investment in equity shares				
Investment in equity shares	–	–	3.3	3.3
Total	–	–	3.3	3.3
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	207.1	55.5	262.6
Cross currency swaps	–	90.9	–	90.9
Total	–	298.0	55.5	353.5

2014 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	208.3	–	208.3
Total	–	208.3	–	208.3
Debt securities				
UK Government investment securities	1,433.5	–	–	1,433.5
Other listed transferable debt securities	169.2	45.2	7.3	221.7
Total	1,602.7	45.2	7.3	1,655.2
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	241.9	60.2	302.1
Cross currency swaps	–	21.2	–	21.2
Total	–	263.1	60.2	323.3

Notes to the accounts **cont.**

33. Financial instruments – classification and fair value measurement continued

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Level 1: Debt securities – Available-for-sale – Listed

Market prices have been used to determine the fair value of listed debt securities.

Level 2: Derivatives

Derivative products valued using a valuation technique with observable market inputs are interest rate swaps and cross currency swaps. The valuation techniques applied are swap models using present value calculations. The models incorporate various assumptions, including interest rate curves and foreign exchange spot and forward rates.

Level 2: Debt securities – Available-for-sale – Listed

Debt securities for which no market price or executable bid is available at the year end date are valued by one of two methods. Where there are recent market prices or executable bids for the security, these are used as the basis for establishing a year-end price for valuation purposes. Otherwise, a security is priced based on its relative value to comparable bonds.

Level 3: Debt securities – Available-for-sale – Listed

The item included within Level 3 is a mortgage backed security. This is valued using the same valuation technique as Level 2 listed securities, namely by establishing a price based on its relative value to comparable bonds. The unobservable inputs relate to estimates of the likely timing of repayments and, hence, the weighted average life of the security. A change in price of 3%, which can be taken to represent the impact of repayment commencing (if positive) or being set back further (if negative), would change the value of the security by £0.2 million.

Level 3: Investment in equity shares – Available-for-sale – Unlisted

Details of the Level 3 Investment in equity shares is set out in note 16 and represents the Group's holding in Visa Europe Limited. This has been valued at the sterling equivalent of the upfront cash consideration. Currently the preference shares and deferred cash consideration have been assigned a value of nil as they cannot be reliably measured.

Level 3: Derivatives

Critical accounting estimates and judgements

The items included within Level 3 are balance tracking swaps, which have remained in place during the year. These are valued using the same valuation technique as Level 2 derivatives, namely present value calculations based on market interest rate curves. The unobservable inputs relate to the projection of the swap notional amount, which changes over time to match the balance of the underlying mortgage portfolio. Projected mortgage prepayment amounts are used in the modelling of the mortgage portfolio profile. A change of 10% in the prepayment rates used results in a £0.6 million change in the value of the swaps. As changes in the projection of interest and prepayment rates of the underlying mortgage portfolio impact the swap and hedged item equally, the net Income Statement and Statement of Financial Position impact would be negligible.

The following table analyses movements in the Level 3 portfolio for both the Group and the Society.

Group and Society	Investment in equity share 2015 £m	Debt securities 2015 £m	Derivative financial instruments 2015 £m	Debt securities 2014 £m	Derivative financial instruments 2014 £m
As at 1 January	–	7.3	(60.2)	–	(34.6)
Gains/(losses) recognised in the Income Statement					
Interest receivable and similar income	–	0.1	–	–	–
Interest payable and similar expense	–	–	(6.3)	–	(6.4)
Net unrealised gains/(losses) from derivative financial instruments	–	–	4.8	–	(25.7)
Loss recognised in other comprehensive income					
Available-for-sale reserve fair value movement	–	(0.3)	–	–	–
Settlements	–	(0.1)	6.2	–	6.5
Transfers into Level 3 portfolio	3.3	–	–	7.3	–
As at 31 December	3.3	7.0	(55.5)	7.3	(60.2)

Transfers between fair value hierarchies

Transfers between fair value hierarchies occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. Transfers are considered to occur at the end of the reporting period for the purposes of this disclosure. No transfers occurred during 2015.

34. Offsetting financial assets and liabilities

The Group and Society do not have any financial assets or financial liabilities that are offset with the net amount presented in the Statements of Financial Position as IAS 32 *Financial Instruments – Presentation* conditions state that there should be both an enforceable right to set-off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions is met by the Group or the Society.

However, the Group has entered into master netting arrangements such as International Swaps and Derivatives Association (ISDA) master agreements for its derivatives (other than derivatives held by Coventry Building Society Covered Bonds LLP). Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements, which typically provide for the exchange of collateral on a weekly basis to mitigate net mark to market credit exposure.

The Group has also entered into Global Master Repurchase Agreements, including margin collateralisation arrangements, whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event.

Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement due to the structure of the transaction but a CSA has been entered into which provides for full collateralisation when the counterparty bank credit rating falls below a certain threshold.

The table on page 134 shows the net exposure for derivative contracts after netting benefits and collateral and also for sale and repurchase agreements after collateral. The Group did not enter into securities lending or reverse sale and repurchase agreements.

34. Offsetting financial assets and liabilities continued

2015 Group	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	173.0	(106.9)	(24.2)	41.9
Total financial assets	173.0	(106.9)	(24.2)	41.9
Financial liabilities				
Derivative financial instruments	353.5	(106.9)	(222.9)	23.7
Sale and repurchase agreements	851.1	–	(851.1)	–
Total financial liabilities	1,204.6	(106.9)	(1,074.0)	23.7

2014 Group	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	208.3	(125.8)	(39.5)	43.0
Total financial assets	208.3	(125.8)	(39.5)	43.0
Financial liabilities				
Derivative financial instruments	323.3	(125.8)	(178.8)	18.7
Sale and repurchase agreements	708.3	–	(708.3)	–
Total financial liabilities	1,031.6	(125.8)	(887.1)	18.7

* As reported on the Statement of Financial Position.
** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

2015 Society	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	116.3	(106.9)	–	9.4
Total financial assets	116.3	(106.9)	–	9.4
Financial liabilities				
Derivative financial instruments	332.8	(106.9)	(222.9)	3.0
Sale and repurchase agreements	851.1	–	(851.1)	–
Total financial liabilities	1,183.9	(106.9)	(1,074.0)	3.0

2014 Society	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	135.9	(125.8)	(0.6)	9.5
Total financial assets	135.9	(125.8)	(0.6)	9.5
Financial liabilities				
Derivative financial instruments	321.2	(125.8)	(178.8)	16.6
Sale and repurchase agreements	708.3	–	(708.3)	–
Total financial liabilities	1,029.5	(125.8)	(887.1)	16.6

* As reported on the Statement of Financial Position.
** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

For derivative financial assets, collateral received is in the form of both cash and UK Government investment securities. Where cash is received it is included as a liability within deposits from banks (see note 23). Where UK Government investment securities are received, these are not recognised on the Statement of Financial Position, as the Group does not obtain the risks and rewards of ownership (see note 14).

For derivative financial liabilities, collateral paid is in the form of cash and is included as an asset in loans and advances to credit institutions (see note 13).

For sale and repurchase agreements, collateral provided is predominantly in UK Government investment securities with the remainder in cash. Again, cash paid is included as an asset in loans and advances to credit institutions (see note 13). UK Government investment securities are not derecognised as the Group has retained substantially all the risks and rewards of ownership (see note 14).

Cash collateral held and cash collateral pledged are not restricted and are returned at the end of the contract.

35. Capital management

As at 31 December 2015, and throughout the year, the Group complied in full with the capital requirements that were in force. Further information on the Group's capital resources and capital management can be found on page 17 and pages 52 to 58.

36. Related party transactions

The Group is controlled by Coventry Building Society registered in England and Wales, which is also considered to be the ultimate parent.

	Group undertakings		Key management	
	2015 £m	2014 £m	2015 £m	2014 £m
Loans payable to the Society				
Loans outstanding as at 1 January	8,876.1	7,844.3	–	0.3
Loans issued during the year	760.9	1,032.5	0.4	0.3
Impairment	–	(0.7)	–	–
Repayments during the year*	–	–	(0.2)	(0.6)
Loans outstanding as at 31 December	9,637.0	8,876.1	0.2	–
Deposits payable by the Society				
Deposits outstanding at 1 January	176.9	250.9	2.9	2.4
Deposits received during the year**	–	–	1.0	1.3
Repayments during the year*	(67.9)	(74.0)	(0.9)	(0.8)
Deposits outstanding at 31 December	109.0	176.9	3.0	2.9
Net interest income/(expense)				
Interest receivable	277.2	246.4	–	–
Interest payable	(3.9)	(5.4)	–	–
Total	273.3	241.0	–	–
Other income and expenses				
Fees and expenses paid to the Society	7.8	6.7	–	–

* Includes loans and deposits for key management on retirement.
** Includes existing deposits for key management on appointment.

Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiaries.

Deposits payable by the Society to Group undertakings relate to amounts owing to the Society's structured entities, in accordance with the accounting policy set out in note 1. These intercompany balances have been presented within other liabilities on the Statement of Financial Position.

Notes to the accounts cont.

36. Related party transactions continued

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The directors are considered to be the only 'key management' for the purposes of the related party transactions disclosures under IAS 24 *Related Party Disclosures*. Key management personnel also incorporate non-executive directors. No director has any interest in the shares or debentures of any connected undertaking of the Society.

In February 2015, Feike Brouwers entered into an agreement in relation to his decision to resign as an executive director. Further details are provided in the Directors' Remuneration Report (page 81).

In accordance with Section 68 of the Building Societies Act 1986, the Society maintains a register of loans falling within Section 65 made to directors and connected persons. A statement containing requisite particulars of such transactions may be inspected by members at the Society's Annual General Meeting (AGM) or at the Principal Office of the Society during the period 15 days prior to the AGM.

Transactions with related undertakings

Transactions are entered into with related parties in the normal course of business. These include loans, deposits and the payment and recharge of interest and administrative expenses.

Annual Business Statement

For the year ended 31 December 2015

1. Statutory percentages

	2015 %	Statutory limits %
Lending limit	1.3	25.0
Funding limit	20.0	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of the business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus loan impairment less liquid assets, intangible assets and property, plant and equipment. The value of X used is the value at 31 December 2015.

Y = the principal value of, and interest accrued on, loans owed to the Group which are fully secured on residential property. The value of Y used is the value at 31 December 2015.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X = shares and borrowings, being the aggregate of:

I. The principal value of, and interest accrued on, shares in the Society.
II. The principal value of, and interest accrued on, the amounts deposited with the Society or any subsidiary undertaking, by banks, credit institutions and other customers.
III. The principal value of, and interest accrued on, the amounts of debt securities of the Society or any subsidiary undertaking.

The value of X used is the value at 31 December 2015.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals other than bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons that include bodies corporate. The value of Y used is the value at 31 December 2015.

2. Other percentages

	2015 %	2014 %
As a percentage of shares and borrowings:		
Gross capital	5.90	5.90
Free capital	5.77	5.78
Liquid assets	13.8	13.6
As a percentage of mean total assets:		
Profit for the financial year	0.52	0.53
Management expenses	0.42	0.42
Net profit as a percentage of total balance sheet	0.50	0.51

Shares and borrowings represents the total of shares, deposits from banks, other deposits, amounts owed to other customers and debt securities in issue.

Gross capital represents the aggregate of reserves, other equity instruments, subordinated liabilities and subscribed capital.

Free capital represents the aggregate of gross capital and collective impairment less intangible assets and property, plant and equipment.

Annual Business Statement cont.

For the year ended 31 December 2015

3. Information relating to directors

Directors

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Ian Pickering, MA (Cantab), FCA (16.10.1955)	Company Director	Electrocab Limited	01.09.2005
Janet Ashdown, BSc (Hons) (05.07.1959)	Company Director	SIG plc Marshalls plc Nuclear Decommissioning Authority	18.09.2013
Peter Ayliffe, BA (Hons), FCIBS, CMgr (05.03.1953)	Company Director	Chartered Management Institute The Pennies Foundation Monitise plc truRating Limited	01.05.2013
Bridget Blow CBE (02.06.1949)	Company Director	All England Netball Association Limited (appointed 19.09.2015) Bridget Blow Consulting Limited City of Birmingham Symphony Orchestra Kensington Green (Management) Limited	01.02.2007
Roger Burnell, BSc, FCA (08.04.1950)	Company Director	Clarence Mansions Management Company Limited	01.09.2008
Peter Frost, BA (Hons) (27.10.1965)	Building Society Chief Operating Officer	Five Valleys Property Company Limited (appointed 21.01.2015)	01.11.2012
Ian Geden, BSc (Hons), FCII (08.07.1953)	Company Director	Faraday Reinsurance Co. Limited Faraday Underwriting Limited	01.09.2008
John Lowe, BA (Oxon), ACA (26.10.1972)	Building Society Finance Director	Arkose Funding Limited Coventry Financial Services Limited Coventry Property Services Limited Five Valleys Property Company Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Mortgages Limited Godiva Savings Limited Godiva Securities and Investments Limited ITL Mortgages Limited	14.10.2010
Mark Parsons, BA (Hons), FCMA (24.10.1961)	Building Society Chief Executive	Godiva Mortgages Limited ITL Mortgages Limited The Royal Latin School	01.07.2014
Glyn Smith, MA (Cantab), FCA (15.09.1952)	Company Director	Covent Garden Market Authority Reclaim Fund Limited (appointed 04.02.2015) FCO Services	22.09.2010

Documents may be served on the above named directors at: Coventry Building Society, c/o Ernst & Young LLP, 1 Bridgewater Place, Leeds LS11 5QR.

In 2010 the Society appointed John Lowe (Finance Director) to the Board. A service contract has been entered into which is terminable by John Lowe on six months' notice and by the Society on one year's notice.

In 2012 the Society appointed Peter Frost (Chief Operating Officer) to the Board. A service contract has been entered into which is terminable by Peter Frost on six months' notice and by the Society on one year's notice.

In 2014 the Society appointed Mark Parsons (Chief Executive) to the Board. A service contract has been entered into which is terminable by Mark Parsons on six months' notice and by the Society on one year's notice.

4. Principal office

Coventry Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of the principal office is: Economic House, PO Box 9, High Street, Coventry CV1 5QN.

Glossary

The following glossary defines terminology within the Annual Report & Accounts to assist the reader and to facilitate comparison with publications by other institutions:

Term	Definition
Additional Tier 1 (AT 1) capital	Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to Common Equity Tier 1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as Permanent Interest Bearing Shares (PIBS).
Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Available-for-sale reserve (AFS)	The Available-for-sale reserve contains unrealised gains and losses arising from changes in the fair value of non-derivative financial assets that are categorised as Available-for-sale.
Average loan to value (LTV)	The average of individual loan to values (simple average). The average loan to value of the residential mortgage book, weighted by balance (balance weighted). For indexed loan to value – see 'Indexed loan to value'.
Basel I floor	A 'floor', currently 80%, applied to the Basel I approach which had a fixed risk weighting for assets. The Basel I framework was issued in 1988 and set out recommendations on banking regulation made by the Basel Committee on Banking Supervision.
Basel III	The Basel Committee on Banking Supervision issued proposals for a strengthened capital regime in response to the financial crisis, which are referred to as Basel III. These standards were implemented in the European Union via CRD IV, which came into force on 1 January 2014.
Basis point	One hundredth of a percent (0.01 percent). Used when quoting movements in interest rates and yields on securities.
Business risk	Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors.
Buy to let mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital Conservation Buffer (CCoB)	A buffer for all banks that can be used to absorb losses while avoiding breaching minimum capital requirements. Phased in from January 2016 (0.625% from 1 January 2016, increasing to 2.5% by 1 January 2019).
Capital requirements	Amount of capital required to be held by the Group to cover the risk of losses and to protect against excessive leverage. The level is set by regulators and the firm's own assessment of its risk profile.
Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV)	CRD IV is the European Union legislation (part regulation and part directive) which came into force from 1 January 2014 to implement Basel III, revising the capital requirements framework and introducing liquidity requirements, which regulators use when supervising firms.
Capital resources	Capital comprising the general reserve, Available-for-sale reserve, eligible Additional Tier 1 capital less all required regulatory adjustments.
Certificates of deposit	Bearer-negotiable instruments issued on the receipt of a fixed term deposit at a specified interest rate.
Collateral	Security pledged by the borrower to the lender in case of default.
Collective assessment of impairments	Where impairment is identified within a portfolio that comprises assets with similar characteristics, but such impairment cannot be separately identified, a collective impairment assessment takes place using appropriate statistical techniques.
Common Equity Tier 1 (CET 1) capital	Common Equity Tier 1 capital comprises general reserves and the Available-for-sale reserve, less regulatory deductions. Common Equity Tier 1 must absorb losses on a going concern basis.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Conduct risk	The risk that the Society's actions or behaviours fail to deliver good customer outcomes.
Contractual maturity	The date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.
Core Capital Deferred Shares (CCDS)	A form of Common Equity Tier 1 (CET 1) capital. The Society's Perpetual Capital Securities (PCS) convert into CCDS at the rate of one CCDS for every PCS if the end point CET 1 ratio, calculated on either an individual or consolidated basis, falls below 7%.
Council of Mortgage Lenders (CML)	A trade association for the residential mortgage lending industry.
Countercyclical Buffer (CCyB)	A buffer that can be varied over the financial cycle to match the resilience of the banking system to the scale of risk it faces. Individual banks' buffers will depend on the geographical composition of their exposures. Applies now but currently set at 0%.

Glossary **cont.**

Term	Definition
Countercyclical Leverage Buffer	As a guiding principle, the FPC sets the CCLB rate at 35% of the risk weighted CCyB (ranges from 0% to 0.9%). Applies now but currently set at 0%.
Covered bonds	Debt securities that are backed by both the resources of the issuer and a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Society issues covered bonds as part of its funding activities.
Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due.
Currency swap	An arrangement in which two parties exchange equivalent principal amounts of different currencies at inception and subsequently exchange interest payments on the principal amounts. At the maturity of the swap, the principal amounts are re-exchanged at the original rates, protecting the participants from changes in exchange rates.
Debt securities	Transferable instruments creating or acknowledging indebtedness. They include bonds, certificates of deposit and loan notes. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured on other assets or unsecured.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods resulting from the carry forward of tax losses or unused tax credits from deductible (or taxable) temporary differences, between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit pension plan resulting from past employee service.
Defined benefit pension scheme	A pension or other post-retirement benefit plan offering guaranteed benefits, usually as a fraction of the final salary.
Defined contribution plan	Pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.
Effective Interest Rate (EIR)	The rate of interest income or expense that produces a level yield, either to maturity or to the next re-pricing date, equivalent to the projected cash flows on an instrument.
Effective tax rate	The tax charge in the Income Statement as a percentage of profit before tax.
Encumbered assets	Assets used to secure third party liabilities or otherwise pledged. This excludes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes.
End-point	Full implementation of CRD IV with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A Board approved framework which provides the context, guidance and principles needed for cohesive risk management activity across the Society and its subsidiaries.
European Banking Authority	An independent European Union authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector.
Eurozone	An economic and monetary union (EMU) of European Union member states that have adopted the euro (€) as their common currency and sole legal tender.
Expected loss	A calculation under the IRB approach to estimate the potential losses on current exposures due to expected defaults over a one year time period.
Exposure	The maximum loss that a financial institution might suffer if a borrower or wholesale counterparty fails to meet their obligations.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK.
Financial Ombudsman Service	The Financial Ombudsman Service provides an independent and impartial service to resolve individual complaints that consumers and financial institutions have been unable to settle themselves.
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.

Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every deposit taking firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Fitch Ratings	A credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Forbearance	Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.
Foreign currency risk	The risk of loss arising as a result of movements in exchange rates on investments or obligations in foreign currencies.
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers, less: property, plant and equipment; non-current assets held for sale; and intangible assets.
Funding for Lending Scheme (FLS)	An initiative by the Bank of England and HM Treasury to incentivise banks and building societies to boost their lending to UK households and small and medium sized enterprises, by providing funding to banks and building societies for an extended period.
General reserve	The general reserve is the accumulation of historical and current year profits and includes remeasurements of the defined benefit pension plan and distributions to holders of Perpetual Capital Securities (net of tax).
Gilts	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.
Gross capital	The aggregate of equity, subscribed capital and subordinated liabilities.
Gross mortgage lending	The total of mortgage lending advanced during the year.
IFRIC	The International Financial Reporting Interpretations Committee. IFRIC interprets the application of IAS and IFRS and provides timely guidance on financial reporting issues not specifically addressed in IAS and IFRS, in the context of the International Accounting Standards Board framework.
IFRS/IAS	International Financial Reporting Standards/International Accounting Standards. A set of international accounting standards stating how particular types of transactions and other disclosures should be reported in financial statements.
Impaired loans	Impaired loans are defined as those which are more than three months in arrears or in possession. However, other indicators of impairment may result in provisioning for losses.
Impairment losses	The reduction in value that arises following an impairment review of an asset that determines that the recoverable amount is less than its carrying value.
Impairment provision	Provisions held against assets on the Statement of Financial Position. The provisions represent management's best estimate of losses incurred in the loan portfolio at the Statement of Financial Position/balance sheet date.
Indexed loan to value	Loan to value calculated on the basis of the latest property valuation being adjusted by the relevant House Price Index movement since that date.
Individual assessment of impairment	Impairment is measured specifically for assets that are individually identified as being impaired at the Statement of Financial Position/balance sheet date.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Society's own assessment of the liquidity resources that are required to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on regulatory benchmarks and on Society-specific tests.
Individual Liquidity Guidance (ILG)	Guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.
Interest rate risk	Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings or value because of different interest rates charged for the mortgages and paid for the funding that comprises the bulk of the balance sheet.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold to support all relevant current and future risks. This assessment includes determination of a number of capital buffers to be held in case of potential future economic stress, and provides confirmation that the Society has appropriate processes in place to ensure compliance with regulatory requirements.
Internal Ratings Based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under Pillar 1. The IRB approach may only be used with permission from the PRA.
ISDA	International Swaps and Derivatives Association is the global trade association for over-the-counter (OTC) derivatives and providers of the industry-standard documentation for derivative transactions.

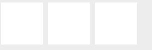
Glossary **cont.**

Leverage ratio	A calculation brought in as part of CRD IV which measures the relationship between eligible Tier 1 capital and exposures to on and off-balance sheet items. The Society's calculation reflects constraints on the inclusion of AT 1 capital under the FPC's UK leverage ratio framework.
LIBOR	London Inter-Bank Offer Rate. A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.
Liquid assets	An amount as defined by the Building Societies (Accounts and Related Provisions) Regulations 1998. This comprises cash in hand, balances with the Bank of England, debt securities (including gilts), loans to credit institutions and other liquid assets.
Liquidity and funding risk	Liquidity risk is the risk the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk.
Liquidity Coverage Ratio (LCR)	A measure brought in as part of CRD IV which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions. A binding minimum LCR of 80% applied to the Society from 1 October 2015.
Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprises cash and balances with the Bank of England, UK Government securities and multilateral development banks, other securities and bank deposits and self-issued covered bonds, RMBS and Bank of England approved mortgage portfolios.
Loan to value	The amount of mortgage loan as a percentage of the value of the property.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation.
Market risk	The risk that the value of net income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign currencies.
Material Risk Takers	A group of employees to which the PRA's Remuneration Code applies. Material Risk Takers consists of the Board, senior managers (including those in control functions e.g. Audit, Risk and Compliance) and any other employee receiving total remuneration at a comparable level to senior management, or who could have a material impact on the firm's risk profile.
Medium-term notes	Securities offered by a company to investors, through a dealer, across a range of maturity periods.
Member	A person who holds a share in the Society or has a mortgage loan with the Society.
Minimum requirement for own funds and eligible liabilities (MREL)	A requirement under the Bank Recovery and Resolution Directive (BRRD) which requires deposit takers to hold minimum levels of capital plus debt eligible for bail-in.
Moody's Investor Services	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Mortgage backed securities	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Near-prime	Loans to borrowers with marginally weakened credit histories such that their credit risk is greater than 'prime' customers, but is not considered heavily adverse.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net interest margin	Net interest income as a percentage of average total assets.
Net mortgage lending	The net amount of new lending advanced to customers during the period offset by customer balances settled during the period.
Net Stable Funding Ratio (NSFR)	A ratio which assesses the amount of stable, long-term funding sources (customer deposits and long-term wholesale funding) as a proportion of the Society's less liquid funding requirements. A minimum requirement for the NSFR is due to be set by 1 January 2018.
Operational risk	The risk of loss arising from inadequate internal processes, systems or people, or from external events.
Overnight indexed swap (OIS) rate	A rate reflecting the overnight interest earned or paid in respect of overnight interbank loans, being typically SONIA for sterling loans. OIS is used to value collateralised interest rate derivatives.
Over-the-counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs.
Owner-occupier mortgage	A mortgage on residential property that is to be occupied by the borrower.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Pension fund surplus	The assets in a pension fund that are in excess of its liabilities.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. PIBS rank equally with each other and Perpetual Capital Securities. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than Perpetual Capital Securities) as to principal and interest. Under Basel III are included as Tier 1 under transitional rules only.

Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society. They rank equally with each other and Permanent Interest Bearing Shares (also AT 1 capital) but behind all other creditors of the Society, including subordinated liabilities and the claims of Shareholding Members (other than Permanent Interest Bearing Shares), as to principal and interest.
Pillar 1/2/2A/3	Components of the Basel capital framework. Pillar 1 covers the minimum requirement, Pillar 2 covers supervisory review and Pillar 3 covers disclosures.
Post vesting	Period after which the director may receive payments under the terms of a variable pay award.
PRA Buffer	A buffer to ensure that banks that are more at risk of loss than the system in aggregate have additional capital buffers to reflect that risk.
PRA Remuneration Code	Requirements provided by the PRA on directors' and Material Risk Takers' remuneration.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA is a subsidiary of the Bank of England.
PV200	Present Value 200. A calculation of the theoretical change in the net present value of financial instruments for a 200 basis point (2%) parallel shift in interest rates.
Redenomination risk	The risk that in the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent).
Residential Mortgage Backed Securities (RMBS)	Asset backed securities that represent interests in a group of residential mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Residual maturity	The remaining period to the contractual maturity date of a financial asset or financial liability.
Retail deposits	See Shares.
Risk appetite	The articulation of the level of risk that the Society is willing to accept in order to safeguard the interests of the Society's members, whilst also achieving business objectives.
Risk weighted assets (RWAs)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant capital rules.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.
Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a structured entity which then issues securities (RMBS) backed by the assets. The Society has used residential mortgages as the loan pool for securitisation purposes.
Self-certified mortgage	An owner-occupier mortgage where the lending decision has been based on the borrower's declaration of their income and the applicant has been suitably verified.
Senior unsecured debt funding	Bonds issued by corporate bodies and financial institutions, which are not secured by any collateral and are not subordinated to any other liabilities of the issuer.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities of the Society.
Shares and borrowings	The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
SONIA	A rate reflecting the interest earned or paid in respect of sterling overnight interbank loans.
Sovereign exposure	Exposures to governments and on account of cash balances and deposits with central banks.
Standardised approach	The basic method used to calculate capital requirements for credit and operational risk. In this approach the risk weighting used in the capital calculation is determined by specified percentages.
Stress testing	Testing undertaken to provide an understanding of the Society's resilience to internal and external shocks.
Structured entity	An entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control.
Subordinated liabilities	A form of Tier 2 capital that is unsecured. Subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members (other than holders of Permanent Interest Bearing Shares and Perpetual Capital Securities) as to principal and interest. Under Basel III are included as Tier 2 under transitional rules only.
Subscribed capital	See Permanent Interest Bearing Shares.
Supplementary Leverage Ratio Buffer (SLRB)	Applied to systemically important banks and building societies. As a guiding principle, the FPC sets the buffer at 35% of the risk weighted Systemic Risk Buffers.
Systemic risk buffer (SRB)	Buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.

Glossary **cont.**

Tier 1 capital	A component of regulatory capital comprising Common Equity Tier 1 and Additional Tier 1 capital.
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances.
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with an intention to trade. The Society does not have a trading book.
UK Corporate Governance Code (the Code)	The code (formerly known as the Combined Code), issued by the Financial Reporting Council, that sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders.
Underlying profit	The purpose of this measure is to reflect management's view of the Group's underlying performance with like for like comparisons of performance across years without distortion of one-off volatility and items that are not reflective of the Group's ongoing business activities.
Unencumbered assets	Assets readily available as collateral to secure funding. This includes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes and are therefore readily available as collateral to secure funding.
Wholesale funding	Funding received from large businesses, financial institutions and sovereign entities.



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